

# **CENTENE<sup>®</sup>** Corporation



08043093



**PROCESSED**

**MAR 14 2008**

**J THOMSON  
FINANCIAL**

**REACHING FOR THE SUMMIT 2007 Annual Review**

Received SEC

**MAR 13 2008**

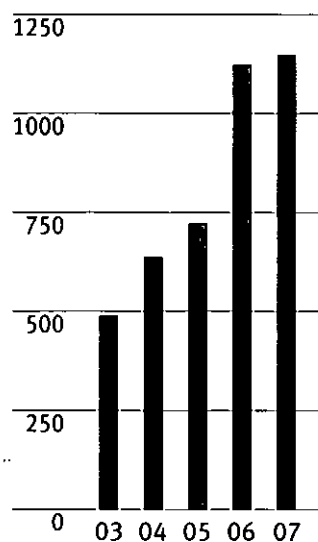
Washington, DC 20549

Centene Corporation is a leading *multi-line* healthcare enterprise that provides managed care programs and related services to individuals receiving benefits under Medicaid, including Supplemental Security Income (SSI) and the State Children's Health Insurance Program (SCHIP). The Company operates health plans in Georgia, Indiana, New Jersey, Ohio, South Carolina, Texas and Wisconsin. In addition, the Company contracts with other healthcare and commercial organizations to provide specialty services, including behavioral health, life and health management, long-term care, managed vision, nurse triage, pharmacy benefits management and treatment compliance. Information is available via the internet at [www.centene.com](http://www.centene.com).

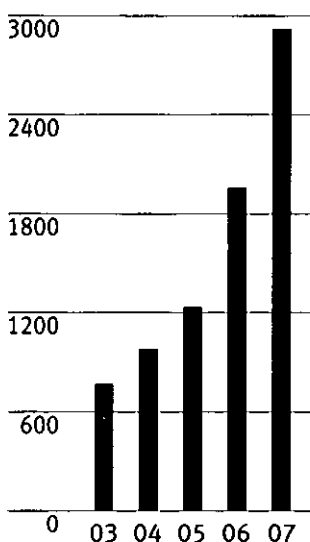
# FINANCIAL SUMMARY

(in thousands)	December 31,				
	2007	2006	2005	2004	2003
Revenue from continuing operations	\$2,919,292	\$1,961,994	\$1,232,202	\$980,693	\$769,730
Earnings from operations	54,093	27,802	52,271	63,773	46,927
Net earnings from continuing operations	41,269	20,940	37,701	43,763	33,270
Total assets	1,119,122	894,980	668,030	527,934	362,692

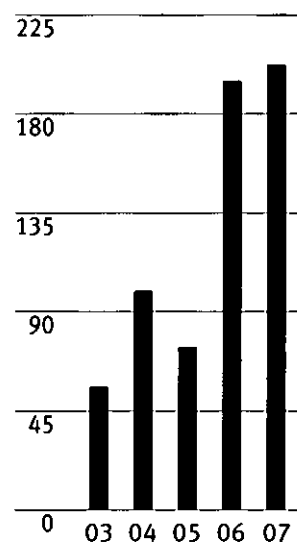
**Membership**  
in thousands



**Revenues**  
\$ in millions



**Cash Flow from Operations**  
\$ in millions



## CHAIRMAN'S LETTER



**Michael F. Neidorff,**  
*Chairman, President and  
Chief Executive Officer*

**A**t Centene, 2007 can be seen as a year in which the recurrent theme of *focus*, organizational strengths and the delivery towards our strategic objectives were visible. Expansion of our unique suite of specialty programs and services, and enrollment in Centene's health and care coordination plans, continue to result in improved services and health outcomes for our more than 1.1 million members and bring greater control over unnecessary costs for state governments. Our cross-selling, strategic acquisition and portfolio platform capabilities have allowed us to build upon our solid footprint in the industry while bringing innovative solutions to our key customers – the states in which we operate. With all of these objectives fully aligned with the ongoing

pursuit of operational excellence, we remain committed to our goal of building an industry leading, *multi-line* healthcare enterprise designed to deliver consistent, sustainable growth.

### **Financial Picture**

In 2007, revenues from continuing operations increased 49% to \$2.9 billion from \$2.0 billion in 2006. Operating cash flows were strong at \$202.2 million, and our balance sheet had cash and investments of \$659.2 million, of which \$33.0 million was free from state regulatory requirements. In the spring, we completed a successful debt offering, issuing \$175 million aggregate principal amount of 7¼% Senior Notes due in 2014. Centene used a portion of the net proceeds from the offering to refinance approximately \$150 million of the debt that was outstanding under our revolving credit facility, all part of our strategy to appropriately manage our capital structure. At year-end, our inability to recognize revenue in 2007 associated with a retroactive rate increase and other contractual changes in Georgia caused confusion in our 2007 financial reporting. Higher than anticipated medical costs in our Ohio Aged, Blind and Disabled (ABD) population also adversely impacted our financial results. We acknowledge that our investors were disappointed, but the Georgia revenue in question will be fully recognized in the

first quarter of 2008, and we continue to move forward in developing aggressive and innovative care coordination models for the ABD population. We remain committed to producing solid 2008 results.

### **Expanding Centene's Footprint**

During the year, we identified additional opportunities to expand into new states through prudent partnerships with existing market participants. In April, Total Carolina Care, a wholly-owned Centene subsidiary, purchased PhyTrust, a Medicaid Medical Home Network (MMHN), and in October, we acquired Physician's Choice, another MMHN. Through these acquisitions, we gained a foothold in the state and ended 2007 with over 31,000 non-risk members. We are confident that South Carolina will provide a promising long-term growth opportunity and look forward to becoming a significant at-risk participant in 2008. We also acquired a minority ownership interest in Access Health Solutions, LLC, one of the largest Medicaid managed care entities in Florida, serving approximately 90,600 members. Access currently provides services to its members on a non-risk basis. To complement our Access investment, we formed Sunshine State Health Plan and are working with state regulators to convert membership to at-risk status during 2008.

## **Update on Our States**

Growth continued in our existing markets as well. In 2007, we again demonstrated the quality of our network and strong relationship with the state of Texas through expansions to our programs in both SCHIP (State Children's Health Insurance Program) and the Texas STAR Plus (a Supplemental Security Income or SSI program). Importantly, we were awarded an exclusive contract – the first of its kind – to serve the state's Foster Care recipients. Based on our technological innovation, we created a Foster Care "health passport" that enables providers, caseworkers and medical consenters to follow a child's medical care through a constantly updated community health record. By combining Centene's technology with our integrated healthcare service delivery model, we achieved a greater degree of accountability for the health outcomes of Foster Care children. We expect this program to start on April 1, 2008, and look forward to working with the state.

We were also able to make significant operational strides in challenging markets. For example, in Georgia, where we have been operating since 2006, after identifying initially higher than anticipated medical costs, we put in place requisite initiatives and processes to manage them. Today, we have stabilized our medical costs and achieved membership at solid levels.

In September, we appointed Michael Cadger, a seasoned and experienced health and managed care industry executive, as President and CEO of Centene's subsidiary, Peach State Health Plan, to further strengthen our position in Georgia. We believe that his managed care expertise will support Peach State's mission to provide better health outcomes to Georgia Medicaid and PeachCare for Kids recipients, while lowering costs to the state.

Another important new growth effort for Centene was the initiation of services to the ABD population in Ohio. Medical costs in the group, not unexpectedly, are challenging and higher than the Medicaid or Covered Families and Children (CFC) population due to the fragility and serious health status of these members. Over time, as we work to manage the integration of these members into our network, we expect that medical costs will normalize, and we are confident in the long-term prospects for both our CFC and ABD products.

## **Specialty Services**

Growth and innovation were highly visible in our CenCorp Health Solutions® (CenCorp), specialty companies as well, which were 20% of Centene's total revenue in 2007, up from an initial 1% in 2004. States have begun to recognize the importance and value of the services being offered, which alone or combined, are designed to deliver improved outcomes,

reliable data, and cost-effective, coordinated care. More importantly, these services provide a means for innovation. For example, AirLogix, our respiratory disease management company; Cardium Health, our chronic disease and health management company; and WorkLife, a leader in work life solutions, were combined to create Nurtur Health Inc. This forward-thinking approach to providing care has created a next generation company that will evolve beyond traditional disease management to meet the growing need for an integrated approach to life and health management. Our vision, to transform the way people view health, places a heavy emphasis on the convergence of life and health management techniques. Nurtur embodies this vision, integrating appropriate capabilities into our service offerings to help people address both the life barriers that get in the way of health, and the health issues that complicate life.

## **Commitment to Operational Excellence**

Our continued successful growth would not be possible without the depth and breadth of expertise of the Company's human capital. Several new executive level positions were created which enhanced our organizational profile and reporting structure. Eric R. Slusser was appointed Executive Vice President and Chief Financial Officer in July, and Mark W. Eggert joined Centene

in November as Executive Vice President, Health Plans. Previously, Mr. Slusser served as Executive Vice President of Finance, Chief Accounting Officer and Controller of Cardinal Health, Inc. Mr. Eggert brings more than 25 years of relevant experience to Centene, most recently as the Associate Vice Chancellor and Deputy General Counsel for Washington University in St. Louis. In this role, he worked extensively on healthcare delivery systems, contracting and regulatory matters for the School of Medicine. In May, Edmund E. Kroll was named Senior Vice President, Finance and Investor Relations. Mr. Kroll was formerly Managing Director and Senior Health Care Services Analyst for Cowen & Company, LLC for approximately ten years, where his research coverage focused on the managed care industry, including Centene.

We also welcomed Pamela A. Joseph, Vice Chairman of U.S. Bancorp, to our board of directors. Ms. Joseph's extensive business management and technology expertise, along with her successful track record of managing compliance-related issues, will serve as a valuable resource as we continue to grow our business.

As part of our succession planning strategy, we continue to rotate several members of our senior staff into different

corporate roles, enabling them to gain new experience while diversifying their knowledge of and perspective on the Company.

In 2008 and beyond, our internal focus will be to continue to enhance our systems infrastructure and operating processes such as medical management, provider contracting, claims processing, and other back office functions, thereby strengthening our overall foundation in support of Centene's next level of growth. We are also working diligently to test and enhance our compliance systems and risk management programs as we have done historically. We will continue to do so into the future.

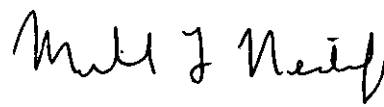
### Looking Ahead

As we enter 2008, we will continue to execute on the implementation of our *multi-line* strategy, which combines our core business with ongoing investments in our specialty companies. This strategy provides us with a greater flexibility to expand our opportunities in Temporary Assistance for Needy Families (TANF), SCHIP, and SSI, and, for the first time in 2008, Special Needs Plans. We are also working to identify opportunities in life and health management, and other specialty company platforms, as well as to consider other premium-based or fee-for-service lines of business that would provide additional revenue diversity. Particular

emphasis in the coming year will be focused on expanding the external business of our specialty company operations. For example, by selling our PBM services to third party vendors, we could offer them an efficient means to bring cost-effective pharmaceuticals to their plans.

The need for quality healthcare and broader coverage of the 47 million uninsured Americans\* is a high priority for Centene. We will continue to serve all of our constituents with a firm commitment to provide cost-effective, high quality healthcare. As an industry leader, we are constantly seeking to identify solutions that can satisfy the demand at the state level to enable more individuals to receive health care coverage. We are proud of what our team has accomplished in 2007 and look forward to building on that success in 2008 and beyond. I would like to thank our employees for their continuing commitment to our goal of "*Reaching for the Summit*," and our shareholders for their continuing investment and confidence.

Sincerely,

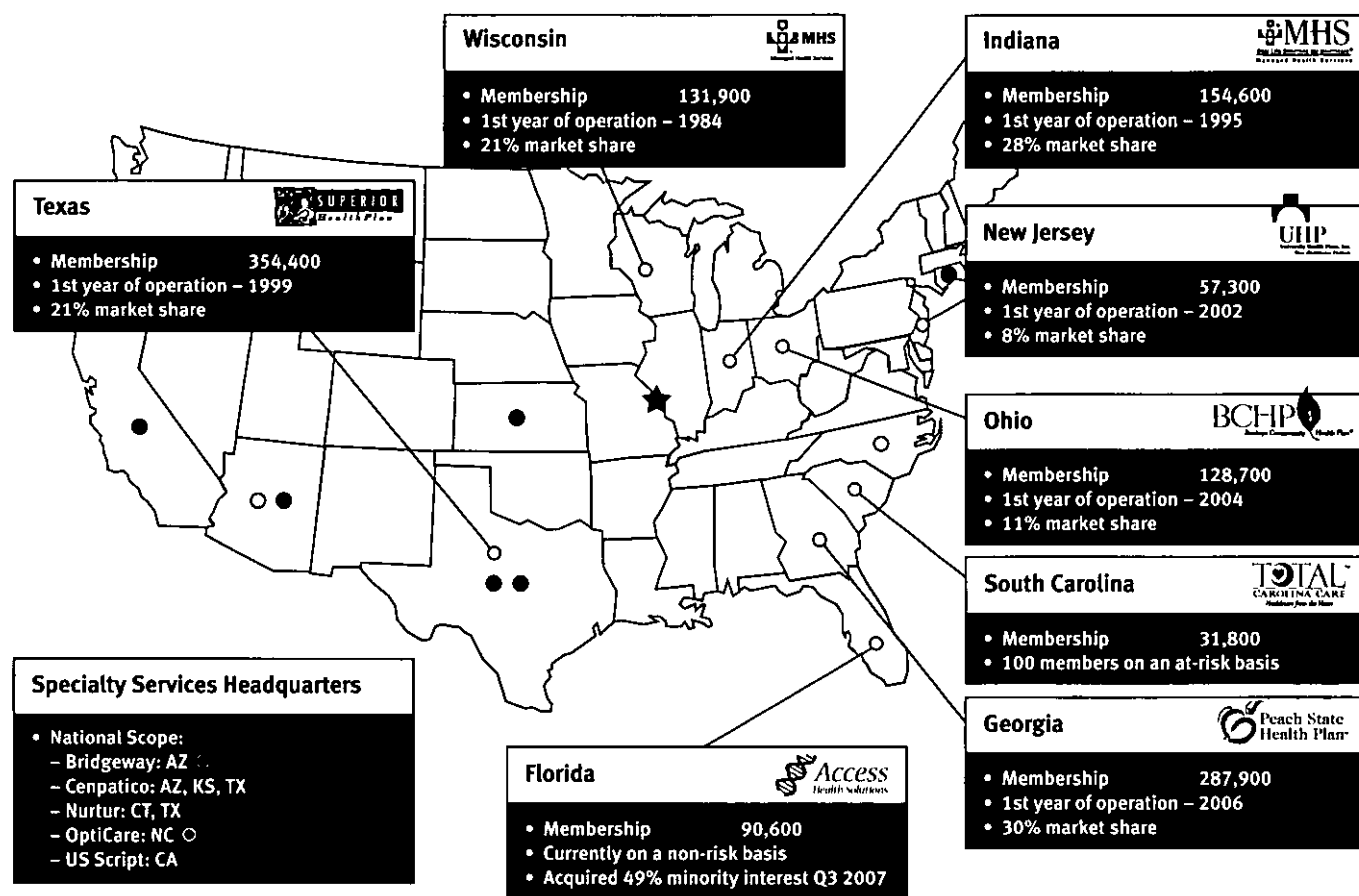


Michael F. Neidorff

\* U.S. Census Bureau 2006

# CENTENE – A DIFFERENTIATED PLATFORM

## Health plans and complementary specialty services



## 2007 OPERATIONS REVIEW

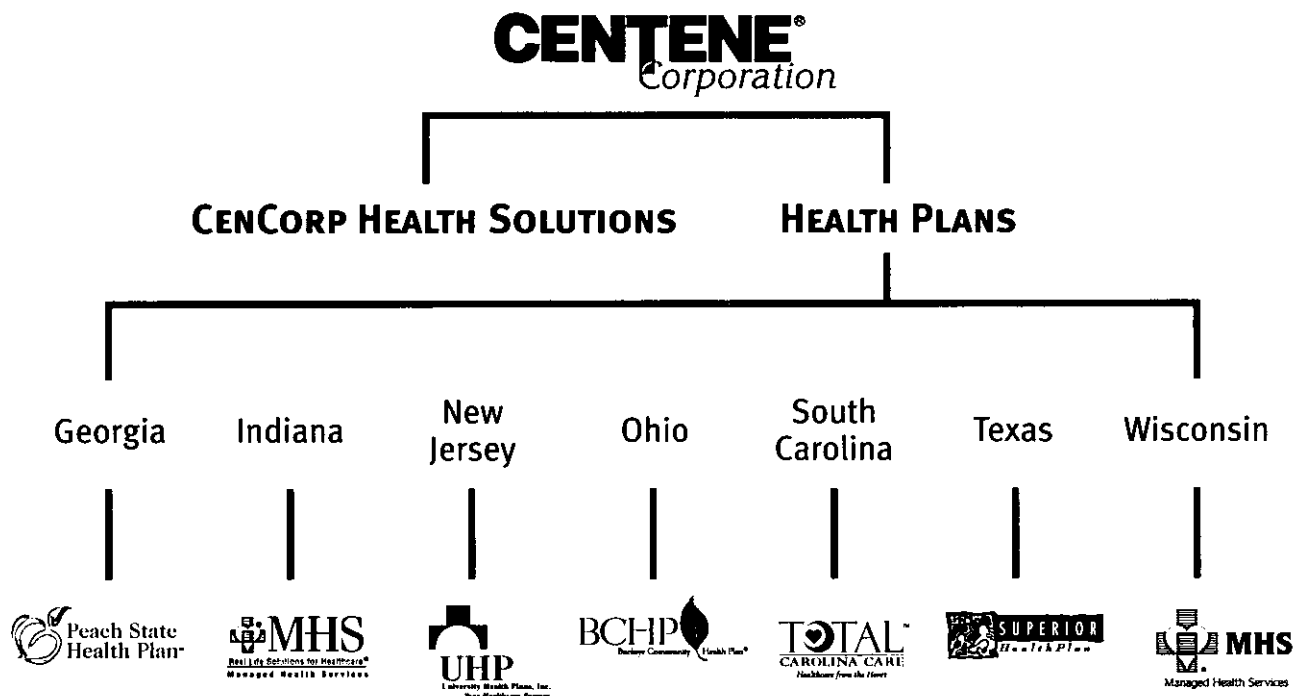
## HEALTH PLANS

Central to Centene's operating philosophy is a commitment to our core business – providing managed care programs and related services to individuals receiving benefits under Medicaid, including SSI and SCHIP.

The Medicaid market is significant. According to the federal Centers for Medicare and Medicaid Services (CMS), it currently stands at well over

\$300 billion, and, as such, it is one of the largest publicly funded programs in the United States. Today only about one-third of these dollars are currently managed in health plans like Centene's. There are 56 Medicaid programs: one for each state, as well as the District of Columbia, and each of the U.S. territories. Many states have adopted the Medicaid managed care model versus the traditional fee-for-service model as the means by

which they deliver healthcare and control costs. This also includes states that automatically enroll Medicaid recipients who don't select a health plan; collectively, they are referred to as mandated managed care states. Of the 44 state programs that have mandated managed care programs for their Medicaid recipients, Centene operates health plans in seven of these states.





More specifically, our health plan product offerings in these states include:

- **Medicaid** – health insurance for low-income families and individuals with disabilities; tends to be a younger population; includes TANF.
- **SCHIP** – plans for children whose families earn too much to qualify for Medicaid, but not enough to afford private health coverage.
- **SSI** – covers low-income persons with chronic physical disabilities or behavioral health impairments – includes ABD; SSI recipients typically utilize more services due to their critical health issues.
- **Foster Care and Special Needs Plans** – in 2008, we will also begin to offer an innovative new plan for Foster Care children in Texas and Special Needs Plans for people who are enrolled in both Medicare and Medicaid (dual-eligibles).

Centene believes that by functioning as the key constituency between Medicaid members and the states, we can administer the healthcare programs more efficiently through our signature, de-centralized approach. The result is accessible, high-quality, and culturally-sensitive healthcare coverage in our communities.

At year end, Centene covered more than 1.1 million lives. While there are conditions that can materially impact our costs – upper respiratory disease, diabetes, high-risk and premature births, and ER utilization – Centene’s programs are predicated upon the goal of attaining better health outcomes for our members. Through outreach, education and physician endorsement, our programs are designed to help members navigate the inherently complex healthcare system, thereby ensuring that they receive appropriate and medically necessary services, as well as to manage routine or chronic health problems more effectively.

Over the last several years, we have consistently demonstrated our ability to grow, whether it’s within our existing markets, via expansion into new markets, by adding new product services, or through a state bidding process. The opportunities for growth in our existing states, as well as the opportunities for new business, continue to be dramatic.

We continue to broaden our specialty services offerings to address areas that we believe have been traditionally overlooked by Medicaid managed care organizations, including behavioral health, life and health management, long-term care programs, managed vision, nurse triage, pharmacy benefits management and treat-

ment compliance. We endeavor to assist states in balancing premium rates, benefit levels, member eligibility, policies and practices, and provider compensation. In addition, our *multi-line* business approach means we can diversify our revenue and help control our medical costs.

Centene’s success is the direct result of our ability to manage these costs, as well as to operate our health plans and back office in the most efficient manner.

With a general election looming in 2008, public sentiment increasingly favors action on covering more of the uninsured. Centene wants to help states respond to this growing demand. Moreover, as uncertain economic times create budget headwinds, more states will likely embrace our cost-effective programs, particularly as their Medicaid populations increase. In summary, we believe that Centene is a growth company in a growth category.

## SPECIALTY SERVICES



Centene's goal is to deliver consistent, sustainable growth to support its strategic objective of building a diversified *multi-line* healthcare enterprise. The expansion and integration of our Specialty Services are a fundamental part of that strategy and complement our core Medicaid managed care business.

In 2004, Specialty Services accounted for less than 1% of our annual revenue. In just three years, it has grown to 20% of Centene's total revenue. Expansion in this segment can be attributed to acquisitions, organic growth, and contract awards exclusive of our health plans.

Currently, Specialty Services is national in scope. It has grown from Cenpatico, which offers behavioral healthcare

services; NurseWise, a 24/7 nurse triage phone line providing health education; and *ScriptAssist*, a treatment adherence program, to now include US Script, a pharmacy benefits manager (PBM); Nurtur, a life and health management and wellness company; OptiCare, a managed vision provider; and Bridgeway, a long-term care company.

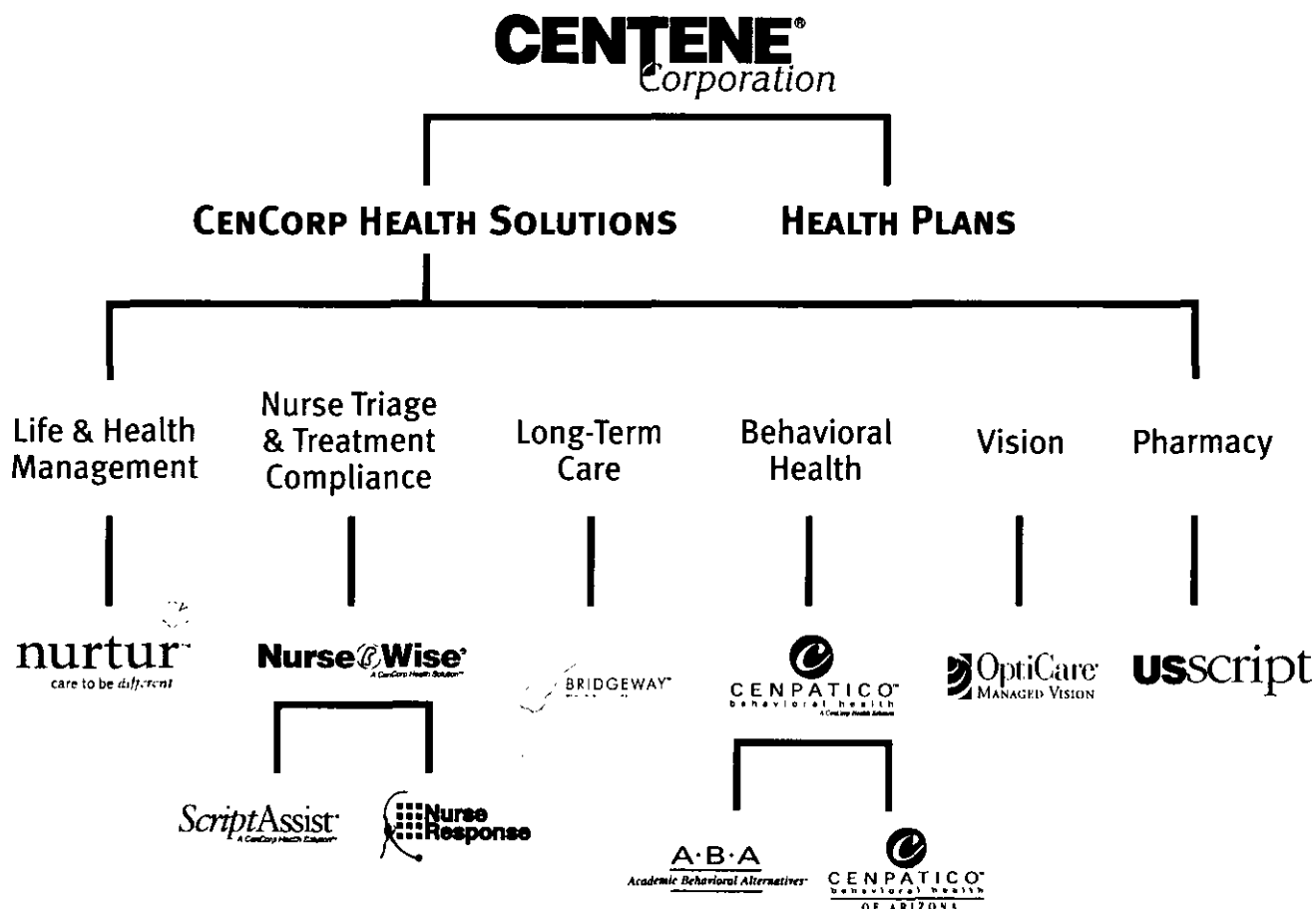
Our ability to provide this comprehensive suite of services enables us to offer a more seamless medical delivery to our own health plans, as well as a compelling value proposition to third parties, such as commercial insurers. It is also more cost efficient for our health plans, as there is no need to hire third parties to provide these ancillary services,

and we retain the margin internally. Finally, when we sell to outside third parties, we can offer our services at the same competitive rates that we charge our health plans.

Centene's Specialty Services create multiple cross-selling opportunities, too. For example, once we establish a presence in a state, that relationship can, in turn, position us for a health plan contract for traditional Medicaid services and

vice-versa. Additionally, in an existing core Medicaid market where we have a health plan contract, we have the potential to layer in specialty services later on.

Going forward, we plan to expand into more specialty companies that will further distinguish Centene in the marketplace.



## QUARTERLY SELECTED FINANCIAL INFORMATION

(In thousands, except share data and membership data)	For the Quarter Ended,			
	March 31, 2007	June 30, 2007 <sup>(1)</sup>	September 30, 2007	December 31, 2007 <sup>(2)</sup>
Total revenues	\$664,234	\$727,731	\$749,888	\$777,439
Net earnings from continuing operations	11,597	10,175	16,464	3,033
Discontinued operations, net of tax	26,614	7,607	(528)	(1,560)
Net earnings	\$ 38,211	\$ 17,782	\$ 15,936	\$ 1,473
Per share data:				
Basic:				
Continued operations	\$ 0.27	\$ 0.23	\$ 0.38	\$ 0.07
Discontinued operations	0.61	0.18	(0.01)	(0.04)
Basic earnings per common share	\$ 0.88	\$ 0.41	\$ 0.37	\$ 0.03
Diluted:				
Continued operations	\$ 0.26	\$ 0.23	\$ 0.37	\$ 0.07
Discontinued operations	0.59	0.17	(0.01)	(0.04)
Diluted earnings per common share	\$ 0.85	\$ 0.40	\$ 0.36	\$ 0.03
Period end membership	1,103,300	1,131,500	1,137,300	1,146,600

(1) Includes a \$3.0 million pre-tax, cash contribution of a portion of the FirstGuard sale proceeds to the company's charitable foundation.

(2) Includes \$4.2 million pre-tax premium revenue refund to the State of Indiana and a \$9.4 million pre-tax charge for impairment and restructuring.

(In thousands, except share data and membership data)	For the Quarter Ended,			
	March 31, 2006 <sup>(1)</sup>	June 30, 2006 <sup>(2)</sup>	September 30, 2006	December 31, 2006
Total revenues	\$378,790	\$417,977	\$547,432	\$617,795
Net earnings from continuing operations	6,554	439	4,696	9,251
Discontinued operations, net of tax	2,212	4,526	(75,889)	4,582
Net earnings (loss)	\$ 8,766	\$ 4,965	\$ (71,193)	\$ 13,833
Per share data:				
Basic:				
Continued operations	\$ 0.15	\$ 0.01	\$ 0.11	\$ 0.21
Discontinued operations	0.05	0.11	(1.76)	0.11
Basic earnings (loss) per common share	\$ 0.20	\$ 0.12	\$ (1.65)	\$ 0.32
Diluted:				
Continued operations	\$ 0.15	\$ 0.01	\$ 0.10	\$ 0.21
Discontinued operations	0.05	0.10	(1.72)	0.10
Diluted earnings (loss) per common share	\$ 0.20	\$ 0.11	\$ (1.62)	\$ 0.31
Period end membership	722,100	951,500	1,025,100	1,123,300

(1) Includes \$4.7 million pre-tax implementation expenses related to Georgia.

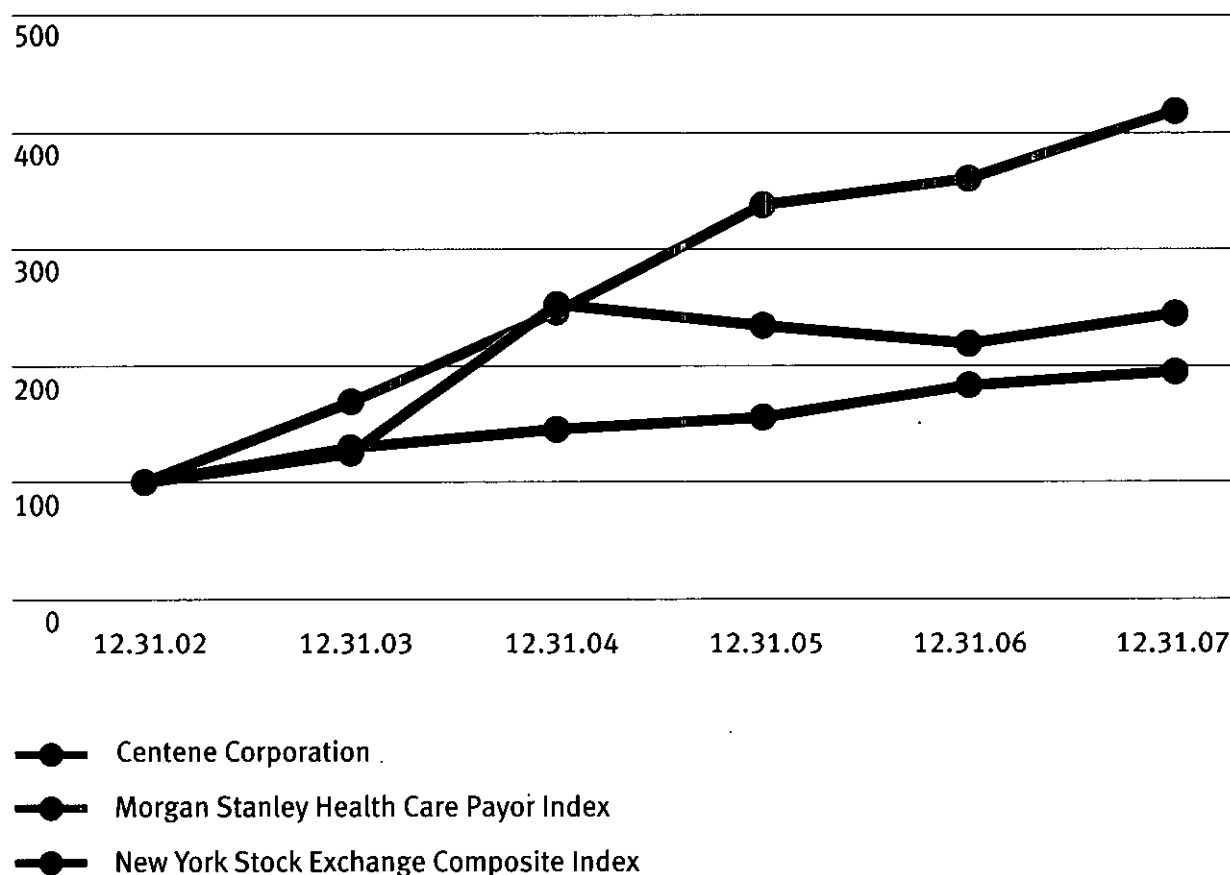
(2) Includes \$8.1 million pre-tax adverse medical cost development in estimated medical claims liabilities from continuing operations from the first quarter of 2006.

## SELECTED FINANCIAL DATA

(In thousands, except share data)	Year Ended December 31,				
	2007	2006	2005	2004	2003
<b>Statement of Operations Data:</b>					
Revenues:					
Premium	\$2,759,018	\$1,844,452	\$1,211,023	\$ 965,923	\$ 758,338
Premium tax	79,572	37,961	7,214	5,503	1,425
Service	80,702	79,581	13,965	9,267	9,967
Total revenues	2,919,292	1,961,994	1,232,202	980,693	769,730
Expenses:					
Medical costs	2,324,486	1,555,658	994,517	782,307	626,192
Cost of services	61,454	60,506	5,851	8,065	8,323
General and administrative expenses	399,687	280,067	172,349	121,045	86,863
Premium tax expense	79,572	37,961	7,214	5,503	1,425
Total operating expenses	2,865,199	1,934,192	1,179,931	916,920	722,803
Earnings from operations	54,093	27,802	52,271	63,773	46,927
Other income (expense):					
Investment and other income	25,169	16,416	9,106	6,336	5,160
Interest expense	(15,626)	(10,636)	(3,990)	(680)	(194)
Earnings before income taxes	63,636	33,582	57,387	69,429	51,893
Income tax expense	22,367	12,642	19,686	25,666	19,504
Minority interest	—	—	—	—	881
Net earnings from continuing operations	41,269	20,940	37,701	43,763	33,270
Discontinued operations, net of income tax (benefit) expense of \$(30,899), \$9,335, \$10,538, \$309 and \$0, respectively	32,133	(64,569)	17,931	549	—
Net earnings (loss)	\$ 73,402	\$ (43,629)	\$ 55,632	\$ 44,312	\$ 33,270
Net earnings (loss) per common share:					
Basic:					
Continuing operations	\$ 0.95	\$ 0.49	\$ 0.89	\$ 1.07	\$ 0.93
Discontinued operations	0.74	(1.50)	0.42	0.01	—
Basic earnings (loss) per common share	\$ 1.69	\$ (1.01)	\$ 1.31	\$ 1.09	\$ 0.93
Diluted:					
Continuing operations	\$ 0.92	\$ 0.47	\$ 0.84	\$ 1.00	\$ 0.87
Discontinued operations	0.72	(1.45)	0.40	0.01	—
Diluted earnings (loss) per common share	\$ 1.64	\$ (0.98)	\$ 1.24	\$ 1.02	\$ 0.87
Weighted average number of common shares outstanding:					
Basic	43,539,950	43,160,860	42,312,522	40,820,909	35,704,426
Diluted	44,823,082	43,613,622	45,027,633	43,616,445	38,422,152

(In thousands)	December 31,				
	2007	2006	2005	2004	2003
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 268,584	\$ 271,047	\$ 147,358	\$ 84,105	\$ 64,346
Investments and restricted deposits	390,611	197,197	185,697	208,255	220,335
Total assets	1,119,122	894,980	668,030	527,934	362,692
Medical claims liabilities	335,856	249,864	139,687	139,602	106,569
Long-term debt	206,406	174,646	92,448	46,973	7,616
Total stockholders' equity	415,047	326,423	352,048	271,312	220,115

## STOCK PERFORMANCE GRAPH *dollars*



Our common stock has been listed for trading on the New York Stock Exchange under the symbol "CNC" since October 16, 2003 and on the Nasdaq National Market under the symbol "CNTE" from December 13, 2001 to October 15, 2003. The graph above compares the cumulative total stockholder return on our common stock for the period from December 31, 2002 to December 31, 2007, with the cumulative total return of the New York Stock Exchange Composite

Index, and the Morgan Stanley Health Care Payor Index over the same period. The graph assumes an investment of \$100 on December 31, 2002 in our common stock (at the last reported sale price on such date), the New York Stock Exchange Composite Index and the Morgan Stanley Health Care Payor Index, and assumes the reinvestment of any dividends.

### Other Information

We included as Exhibits 31.1 and 31.2 to our Annual Report on Form 10-K for fiscal year 2007 filed with the

Securities and Exchange Commission certificates of our Chairman and Chief Executive Officer and our Chief Financial Officer, certifying the quality of our public disclosure. We submitted to the New York Stock Exchange a certificate of our Chairman and Chief Executive Officer certifying, for the prior fiscal year, that he is not aware of any violation by us of New York Stock Exchange corporate governance listing standards.

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from

to

Commission file number: 001-31826

**Centene Corporation**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

7711 Carondelet Avenue

St. Louis, Missouri

(Address of principal executive offices)

620  
Mail Processing  
Section

MAR 13 2008

42-140631 Washington, DC  
(I.R.S. Employer  
Identification Number) 101

63105  
(Zip Code)

Registrant's telephone number, including area code: (314) 725-4477

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.001 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None  
(Title of Each Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based upon the last reported sale price of the common stock on the New York Stock Exchange on June 30, 2007, was \$915.9 million.

As of February 8, 2008, the registrant had 43,663,248 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the registrant's 2008 annual meeting of stockholders are incorporated by reference in Part I, Item 1 and Part III, Items 10, 11, 12, 13 and 14.

## TABLE OF CONTENTS

### Part I

Item 1.	Business	3
Item 1A.	Risk Factors	20
Item 1B.	Unresolved Staff Comments	31
Item 2.	Properties	31
Item 3.	Legal Proceedings	31
Item 4.	Submission of Matters to a Vote of Security Holders	32

### Part II

Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	33
Item 6.	Selected Financial Data	35
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	36
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	48
Item 8.	Financial Statements and Supplementary Data	49
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	50
Item 9A.	Controls and Procedures	50
Item 9B.	Other Information	52

### Part III

Item 10.	Directors, Executive Officers of the Registrant and Corporate Governance	52
Item 11.	Executive Compensation	52
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	52
Item 13.	Certain Relationships and Related Transactions, and Director Independence	52
Item 14.	Principal Accountant Fees and Services	52

### Part IV

Item 15.	Exhibits and Financial Statement Schedules	53
	Signatures	87
	Certifications	88

Our trademark, service marks and trade names referred to in this filing include AirLogix, Bridgeway Health Solutions, Buckeye Community Health Plan, Cardium, Cenpatco Behavioral Health, Cenpatco Behavioral Health of Arizona, Centene, FirstGuard Health Plan, Managed Health Services, NurseWise, Nurtur, OptiCare, Peach State Health Plan, PhyTrust, *ScriptAssist*, Smart Start For Your Baby, Superior HealthPlan, Total Carolina Care, US Script and University Health Plans, among others.



## **PART I**

### **Item 1. Business**

#### **OVERVIEW**

We are a multi-line healthcare enterprise operating in two segments: Medicaid Managed Care and Specialty Services. Our Medicaid Managed Care segment provides Medicaid and Medicaid-related health plan coverage to individuals through government subsidized programs, including Medicaid, the State Children's Health Insurance Program, or SCHIP, and Supplemental Security Income Program, or SSI. Medicaid currently accounts for 74% of our membership, while SCHIP and SSI account for 20% and 6%, respectively. Our Specialty Services segment provides specialty services, including behavioral health, life and health management, long-term care programs, managed vision, nurse triage, pharmacy benefits management and treatment compliance, to state programs, healthcare organizations, employer groups and other commercial organizations, as well as to our own subsidiaries on market-based terms. For the year ended December 31, 2007, our revenues from continuing operations, cash flow from operations, and net earnings were \$2.9 billion, \$202.2 million and \$73.4 million, respectively.

Our Medicaid Managed Care membership totaled approximately 1.1 million as of December 31, 2007. We currently have seven health plan subsidiaries offering healthcare services in Georgia, Indiana, New Jersey, Ohio, South Carolina, Texas and Wisconsin. Additionally, effective in July 2007, we acquired a minority interest in Access Health Solutions, LLC, or Access, which provides managed care on a non-risk basis for Medicaid recipients in Florida. We provide member-focused services through locally based staff by assisting in accessing care, coordinating referrals to related health and social services and addressing member concerns and questions. We also provide education and outreach programs to inform and assist members in accessing quality, appropriate healthcare services.

We believe our local approach to managing our health plans, including provider and member services, enables us to provide accessible, quality, culturally-sensitive healthcare coverage to our communities. Our health management, educational and other initiatives are designed to help members best utilize the healthcare system to ensure they receive appropriate, medically necessary services and effective management of routine, severe and chronic health problems, resulting in better health outcomes. We combine our decentralized local approach for care with a centralized infrastructure of support functions such as finance, information systems and claims processing.

Our initial health plan commenced operations in Wisconsin in 1984. We were organized in Wisconsin in 1993 as a holding company for our initial health plan and reincorporated in Delaware in 2001. Our corporate office is located at 7711 Carondelet Avenue, St. Louis, Missouri 63105, and our telephone number is (314) 725-4477. Our stock is publicly traded on the New York Stock Exchange under the ticker symbol "CNC."

We maintain a website with the address [www.centene.com](http://www.centene.com). We are not including the information contained on our website as part of, or incorporating it by reference into, this filing. We make available, free of charge through our website, our Section 16 filings, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to these reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the SEC.

#### **INDUSTRY**

We provide our services to organizations and individuals primarily through Medicaid, SCHIP and SSI programs. The federal Centers for Medicare and Medicaid Services, or CMS, estimated the total Medicaid market was approximately \$313 billion in 2005, and estimate the market will grow to \$680 billion by 2016. According to the most recent information provided by the Kaiser Commission on Medicaid and the Uninsured,

Medicaid spending increased by 2.9% in fiscal 2007 and states appropriated an increase of 6.3% for Medicaid in fiscal 2008 budgets.

Established in 1965, Medicaid is the largest publicly funded program in the United States, and provides health insurance to low-income families and individuals with disabilities. Authorized by Title XIX of the Social Security Act, Medicaid is an entitlement program funded jointly by the federal and state governments and administered by the states. The majority of funding is provided at the federal level. Each state establishes its own eligibility standards, benefit packages, payment rates and program administration within federal standards. As a result, there are 56 Medicaid programs—one for each U.S. state, each U.S. territory and the District of Columbia. Many states have selected Medicaid managed care as a means of delivering quality healthcare and controlling costs, including states that automatically enroll Medicaid recipients who don't select a health plan. We refer to these states as mandated managed care states. Currently, 44 of the 56 programs, including each of the seven states in which we operate health plans, have mandated managed care for some or all of their Medicaid recipients. Eligibility is based on a combination of household income and assets, often determined by an income level relative to the federal poverty level. Historically, children have represented the largest eligibility group.

Established in 1972, and authorized by Title XVI of the Social Security Act, SSI covers low-income persons with chronic physical disabilities or behavioral health impairments. SSI beneficiaries, including Aged, Blind or Disabled, or ABD, program beneficiaries, represent a growing portion of all Medicaid recipients. In addition, SSI recipients typically utilize more services because of their critical health issues.

The Balanced Budget Act of 1997 created SCHIP to help states expand coverage primarily to children whose families earned too much to qualify for Medicaid, yet not enough to afford private health insurance. Some states include the parents of these children in their SCHIP programs. SCHIP is the single largest expansion of health insurance coverage for children since the enactment of Medicaid. Costs related to the largest eligibility group, children, are primarily composed of pediatrics and family care. These costs tend to be more predictable than other healthcare issues which predominantly affect the adult population.

A portion of Medicaid beneficiaries are dual eligibles, low-income seniors and people with disabilities who are enrolled in both Medicaid and Medicare. According to the Centers for Medicare and Medicaid Services, there were approximately seven million dual eligible enrollees in 2006. These dual eligibles may receive assistance from Medicaid for Medicaid benefits, such as nursing home care and/or assistance with Medicare premiums and cost sharing. Dual eligibles also use more services due to their tendency to have more chronic health issues. We serve dual eligibles through our SSI and long-term care programs, and beginning in 2008, through Special Needs Plans.

While Medicaid programs have directed funds to many individuals who cannot afford or otherwise maintain health insurance coverage, they did not initially address the inefficient and costly manner in which the Medicaid population tends to access healthcare. Medicaid recipients in non-managed care programs typically have not sought preventive care or routine treatment for chronic conditions, such as asthma and diabetes. Rather, they have sought healthcare in hospital emergency rooms, which tends to be more expensive. As a result, many states have found that the costs of providing Medicaid benefits have increased while the medical outcomes for the recipients remained unsatisfactory.

Since the early 1980s, increasing healthcare costs, combined with significant growth in the number of Medicaid recipients, have led many states to establish Medicaid managed care initiatives. Continued pressure on states' Medicaid budgets should cause public policy to recognize the value of managed care as a means of delivering quality healthcare and effectively controlling costs. A growing number of states, including each of the seven states in which we operate health plans, have mandated that their Medicaid recipients enroll in managed care plans. Other states are considering moving to a mandated managed care approach. As a result, a significant market opportunity exists for managed care organizations with operations and programs focused on the distinct socio-economic, cultural and healthcare needs of the Medicaid, SCHIP and SSI populations. We believe our approach and strategy enable us to be a growing participant in this market.

## OUR COMPETITIVE STRENGTHS

Our multi-line managed care approach is based on the following key attributes:

- *Strong Historic Operating Performance.* We have increased revenues as we have grown in existing markets, expanded into new markets and broadened our product offerings. We entered the Wisconsin market in 1984, the Indiana market in 1995, the Texas market in 1999, the New Jersey market in 2002, the Ohio market in 2004, the Georgia market in 2006, and the South Carolina market in 2007. We have also increased membership by acquiring Medicaid businesses, contracts and other related assets from competitors in existing markets, most recently in Ohio in 2005 and 2006. Our Medicaid Managed Care membership totaled approximately 1.1 million as of December 31, 2007. For the year ended December 31, 2007, we had revenue from continuing operations of \$2.9 billion, representing a 40% CAGR since the year ended December 31, 2003. We generated cash flow from operations of \$202.2 million and net earnings of \$73.4 million for the year ended December 31, 2007.
- *Medicaid Expertise.* Over the last 20 years, we have strived to develop a specialized Medicaid expertise that has helped us establish and maintain relationships with members, providers and state governments. We have implemented programs developed to achieve savings for state governments and improve medical outcomes for members by reducing inappropriate emergency room use, inpatient days and high cost interventions, as well as by managing care of chronic illnesses. Our experience in working with state regulators helps us implement and deliver programs and services efficiently and affords us opportunities to provide input regarding Medicaid industry practices and policies in the states in which we operate. We work with state agencies on redefining benefits, eligibility requirements and provider fee schedules in order to maximize the number of uninsured individuals covered through Medicaid, SCHIP and SSI and expand these types of benefits offered. Our approach is to accomplish this while maintaining adequate levels of provider compensation and protecting our profitability.
- *Diversified Business Lines.* We continue to broaden our service offerings to address areas that we believe have been traditionally underserved by Medicaid managed care organizations. In addition to our Medicaid and Medicaid-related managed care services, our service offerings include behavioral health, life and health management, long-term care programs, managed vision, nurse triage, pharmacy benefits management and treatment compliance. Through the utilization of a multi-business line approach, we are able to diversify our revenue and help control our medical costs.
- *Localized Approach with Centralized Support Infrastructure.* We take a localized approach to managing our subsidiaries, including provider and member services. This approach enables us to facilitate access by our members to high quality, culturally sensitive healthcare services. Our systems and procedures have been designed to address these community-specific challenges through outreach, education, transportation and other member support activities. For example, our community outreach programs work with our members and their communities to promote health and self-improvement through employment and education on how best to access care. We complement this localized approach with a centralized infrastructure of support functions such as finance, information systems and claims processing, which allows us to minimize general and administrative expenses and to integrate and realize synergies from acquisitions. We believe this combined approach allows us to efficiently integrate new business opportunities in both Medicaid and specialty services while maintaining our local accountability and improved access.
- *Specialized and Scalable Systems and Technology.* Through our specialized information systems, we work to strengthen relationships with providers and states which help us grow our membership base. Our specialized information systems allow us to support our core processing functions under a set of integrated databases which are designed to be both replicable and scalable. Physicians can use claims, utilization and membership data to manage their practices more efficiently, and they also benefit from our timely payments. State agencies can use data from our information systems to demonstrate that their Medicaid populations receive quality healthcare in an efficient manner. These systems also help identify needs for new healthcare and specialty programs. We have the ability to

leverage our platform for one state configuration into new states or for health plan acquisitions. Our ability to access data and translate it into meaningful information is essential to operating across a multi-state service area in a cost-effective manner.

## OUR BUSINESS STRATEGY

Our objective is to become the leading multi-line healthcare enterprise focusing on Medicaid and Medicaid-related services. We intend to achieve this objective by implementing the following key components of our strategy:

- *Increase Penetration of Existing State Markets.* We seek to continue to increase our Medicaid membership in states in which we currently operate through alliances with key providers, outreach efforts, development and implementation of community-specific products and acquisitions. In 2006, we were awarded two regions in connection with Ohio's statewide restructuring of its Medicaid managed care program, expanding the number of counties we serve from three to 27. We also were awarded a Medicaid ABD contract in four regions in Ohio. In Texas, we expanded our operations to the Corpus Christi market in 2006 and began managing care for SSI recipients in February 2007. We may also increase membership by acquiring Medicaid businesses, contracts and other related assets from our competitors in our existing markets or by enlisting additional providers. For example, in 2005 and 2006, we acquired certain Medicaid-related assets in Ohio. In 2006, we began serving members within a long-term care plan in Arizona. In 2008, we began serving Medicare members within Special Needs Plans in Arizona, Ohio, Texas and Wisconsin.
- *Diversify Business Lines.* We seek to broaden our business lines into areas that complement our existing business to enable us to grow and diversify our revenue. We are constantly evaluating new opportunities for expansion both domestically and abroad. For instance, in October 2006, we commenced operations under our managed care program contracts to provide long-term care services in Arizona, and in January 2006, we completed the acquisition of US Script, a pharmacy benefits manager. We are also considering other premium based or fee-for-service lines of business that would provide additional diversity. We employ a disciplined acquisition strategy that is based on defined criteria including internal rate of return, accretion to earnings per share, market leadership and compatibility with our information systems. We engage our executives in the relevant operational units or functional areas to ensure consistency between the diligence and integration process.
- *Address Emerging State Needs.* We work to assist the states in which we operate in addressing the operating challenges they face. We seek to assist the states in balancing premium rates, benefit levels, member eligibility, policies and practices, and provider compensation. For example, in 2007, the Texas Health and Human Services Commission awarded us a contract for Comprehensive Health Care for Children in Foster Care, a new statewide program providing managed care services to participants in the Texas Foster Care program. In 2005, we began performing under our contracts with the State of Arizona to facilitate the delivery of mental health and substance abuse services to behavioral health recipients in Arizona. Effective January 1, 2005, we were awarded a behavioral health contract to serve SCHIP members in Kansas. By helping states structure an appropriate level and range of Medicaid, SCHIP and specialty services, we seek to ensure that we are able to continue to provide those services on terms that achieve targeted gross margins, provide an acceptable return and grow our business.
- *Develop and Acquire Additional State Markets where Enrollment is Mandated.* We continue to leverage our experience to identify and develop new markets by seeking both to acquire existing business and to build our own operations. We expect to focus expansion on states where Medicaid recipients are mandated to enroll in managed care organizations, because we believe member enrollment levels are more predictable in these states. For example, effective June 1, 2006, we began managing care for Medicaid and SCHIP members in Georgia. In addition, we focus our attention on states converting to managed care. For example, in 2007, we entered the South Carolina market and in December 2007, we began participating in the state's conversion to at-risk managed care.

- *Leverage Established Infrastructure to Enhance Operating Efficiencies.* We intend to continue to invest in infrastructure to further drive efficiencies in operations and to add functionality to improve the service provided to members and other organizations at a low cost. Our centralized functions enable us to add members and markets quickly and economically. For example, during 2005, we opened an additional claims processing facility to accommodate our planned growth initiatives for this centralized function.
- *Maintain Operational Discipline.* We monitor our cost trends, operating performance, regulatory relationships and the Medicaid political environment in our existing markets. We seek to operate in markets that allow us to meet our internal metrics including membership growth, plan size, market leadership and operating efficiency. We may divest contracts or health plans in markets where the state's Medicaid environment, over a long-term basis, does not allow us to meet our targeted performance levels. We use multiple techniques to monitor and reduce our medical costs, including on-site hospital review by staff nurses and involvement of medical management and finance personnel in significant cases. Our financial management teams evaluate the financial impact of proposed changes in provider relationships. We also conduct monthly reviews of member demographics for each health plan.

## MEDICAID MANAGED CARE

### Health Plans

We have regulated subsidiaries offering healthcare services in each state we serve. The table below provides summary data for the state markets we currently serve:

State	Local Health Plan Name	First Year of Operations Under the Company	Counties Served at December 31, 2007	Market Share <sup>(1)</sup>	Membership at December 31, 2007
Georgia	Peach State Health Plan	2006	90	30.0%	287,900
Indiana	Managed Health Services	1995	92	27.8%	154,600
New Jersey	University Health Plans	2002	20	7.7%	57,300
Ohio	Buckeye Community Health Plan	2004	43	10.5%	128,700
South Carolina	Total Carolina Care	2007	44	5.0%	31,800
Texas	Superior HealthPlan	1999	217	21.1%	354,400
Wisconsin	Managed Health Services	1984	29	21.4%	131,900

(1) Represents Medicaid and SCHIP membership as of December 31, 2007 as a percentage of total eligible Medicaid and SCHIP members in each state. SSI programs are excluded.

All of our revenue is derived from operations within the United States and its territories. We generally receive a fixed premium per member per month pursuant to our state contracts. Our medical costs have a seasonality component due to cyclical illness, for example cold and flu season, resulting in higher medical expenses beginning in the fourth quarter and continuing throughout the first quarter of each year. Our managed care subsidiaries in Georgia, Indiana, Ohio, Texas and Wisconsin had revenues from their respective state governments that each exceeded 10% of our consolidated total revenues in 2007. Other financial information about our segments is found in Note 19 of our Notes to Consolidated Financial Statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K.

### Benefits to States

Our ability to establish and maintain a leadership position in the markets we serve results primarily from our demonstrated success in providing quality care while reducing and managing costs, and from our

specialized programs in working with state governments. Among the benefits we are able to provide to the states with which we contract are:

- *Significant cost savings compared to state paid reimbursement for services.* We bring bottom-line management experience to our health plans. On the administrative and management side, we bring experience including quality of care improvement methods, utilization management procedures, an efficient claims payment system, and provider performance reporting, as well as managers and staff experienced in using these key elements to improve the quality of and access to care.
- *Data-driven approaches to balance cost and verify eligibility.* Our Medicaid health plans have conducted enrollment processing and activities for state programs since 1984. We seek to ensure effective enrollment procedures that move members into the plan, then educate them and ensure that they receive needed services as quickly as possible. Our IT department has created mapping/translation programs for loading membership and linking membership eligibility status to all of Centene's subsystems.
- *Establishment of realistic and meaningful expectations for quality deliverables.* We have collaborated with state agencies in redefining benefits, eligibility requirements and provider fee schedules with the goal of maximizing the number of individuals covered through Medicaid, SCHIP and SSI programs.
- *Managed care expertise in government subsidized programs.* Our expertise in Medicaid has helped us establish and maintain strong relationships with our constituent communities of members, providers and state governments. We provide access to services through local providers and staff that focus on the cultural norms of their individual communities. To that end, systems and procedures have been designed to address community-specific challenges through outreach, education, transportation and other member support activities.
- *Improved medical outcomes.* We have implemented programs developed to achieve savings for state governments and improve medical outcomes for members by reducing inappropriate emergency room use, inpatient days and high cost interventions, as well as by managing care of chronic illness.
- *Timely payment of provider claims.* We are committed to ensuring that our information systems and claims payment systems meet or exceed state requirements. We continuously endeavor to update our systems and processes to improve the timeliness of our provider payments.
- *Cost saving outreach and specialty programs.* Our health plans have adopted a physician-driven approach where network providers are actively engaged in developing and implementing healthcare delivery policies and strategies. This approach is designed to eliminate unnecessary costs, improve services to members and simplify the administrative burdens placed on providers.
- *Responsible collection and dissemination of utilization data.* We gather utilization data from multiple sources, allowing for an integrated view of our members' utilization of services. These sources include medical and behavioral health claims and encounter data, pharmacy data, vision and dental vendor claims and authorization data from the authorization and case management system utilized by us to coordinate care.
- *Timely and accurate reporting.* Our information systems have reporting capabilities which have been instrumental in identifying the need for new and/or improved healthcare and specialty programs. For state agencies, our reporting capability is important in demonstrating an auditable program.

## Member Programs and Services

We recognize the importance of member-focused delivery of quality managed care services. Our locally-based staff assist members in accessing care, coordinating referrals to related health and social services and addressing member concerns and questions. While covered healthcare benefits vary from state to state, our health plans generally provide the following services:

- primary and specialty physician care
- inpatient and outpatient hospital care
- emergency and urgent care
- prenatal care
- laboratory and x-ray services
- home health and durable medical equipment
- behavioral health and substance abuse services
- 24-hour nurse advice line
- transportation assistance
- vision care
- dental care
- immunizations
- prescriptions and limited over-the-counter drugs
- therapies
- social work services

We also provide the following education and outreach programs to inform and assist members in accessing quality, appropriate healthcare services in an efficient manner:

- *CONNECTIONS* is a community face-to-face outreach and education program designed to create a link between the member and the provider and help identify potential challenges or risk elements to a member's health, such as nutritional challenges and health education shortcomings. *CONNECTIONS* representatives also contact new members by phone or mail to discuss managed care, the Medicaid program and our services. Our *CONNECTIONS* representatives make home visits, conduct educational programs and represent our health plans at community events such as health fairs.
- *Start Smart For Your Baby* is a prenatal and infant health program designed to increase the percentage of pregnant women receiving early prenatal care, reduce the incidence of low birth weight babies, identify high risk pregnancies, increase participation in the federal Women, Infant and Children program, prevent hospital admissions in the first year of life and increase well-child visits. The program includes risk assessments, education through face-to-face meetings and materials, behavior modification plans, assistance in selecting a provider for the infant and scheduling newborn follow-up visits.
- *EPSDT Case Management* is a preventive care program designed to educate our members on the benefits of Early and Periodic Screening, Diagnosis and Treatment, or EPSDT, services. We have a systematic program of communicating, tracking, outreach, reporting and follow-through that promotes state EPSDT programs.
- *Life and Health Management Programs* are designed to help members understand their disease and treatment plan and improve their wellness in a cost effective manner. These programs address medical conditions that are common within the Medicaid population such as asthma, diabetes and pregnancy. Our Specialty Services segment manages many of our life and health management programs. Our SSI program uses a proprietary assessment tool that effectively identifies barriers to care, unmet functional needs, available social supports and the existence of behavioral health conditions that impede a member's ability to maintain a proper health status. Care coordinators develop individual care plans with the member and healthcare providers ensuring the full integration of behavioral, social and acute care services. These care plans, while specific to an SSI member, incorporate "Condition Specific" practices in collaboration with physician partners and community resources.

## Providers

For each of our service areas, we establish a provider network consisting of primary and specialty care physicians, hospitals and ancillary providers. As of December 31, 2007, the health plans we currently serve contracted with the following number of physicians and hospitals:

	<u>Primary Care Physicians</u>	<u>Specialty Care Physicians</u>	<u>Hospitals</u>
Georgia	3,734	12,467	128
Indiana	790	2,935	63
New Jersey	1,379	4,091	69
Ohio	2,412	8,088	122
South Carolina	367	641	6
Texas	6,092	11,019	340
Wisconsin	1,925	4,632	67

Our network of primary care physicians is a critical component in care delivery, management of costs and the attraction and retention of new members. Primary care physicians include family and general practitioners, pediatricians, internal medicine physicians and obstetricians and gynecologists. Specialty care physicians provide medical care to members generally upon referral by the primary care physicians. Specialty care physicians include, but are not limited to, orthopedic surgeons, cardiologists and otolaryngologists. We also provide education and outreach programs to inform and assist members in accessing quality, appropriate healthcare services.

Our health plans facilitate access to healthcare services for our members primarily through contracts with our providers. Our contracts with primary and specialty care physicians and hospitals usually are for one to two-year periods and renew automatically for successive one-year terms, but generally are subject to termination by either party upon 90 to 120 days prior written notice. In the absence of a contract, we typically pay providers at state Medicaid reimbursement levels. We pay physicians under a fee-for-service, capitation arrangement, or risk-sharing arrangement.

- Under our fee-for-service contracts with physicians, particularly specialty care physicians, we pay a negotiated fee for covered services. This model is characterized as having no financial risk for the physician. In addition, this model requires management oversight because our total cost may increase as the units of services increase or as more expensive services replace less expensive services. We have prior authorization procedures in place that are intended to make sure that certain high cost diagnostic and other services are medically appropriate.
- Under our capitated contracts, primary care physicians are paid a monthly fee for each of our members assigned to his or her practice and are at risk for all costs associated with primary and specialty physician and emergency room services. In return for this payment, these physicians provide all primary care and preventive services, including primary care office visits and EPSDT services. If these physicians also provide non-capitated services to their assigned members, they may receive payment under fee-for-service arrangements at standard Medicaid rates.
- Under risk-sharing arrangements, physicians are paid under a capitated or fee-for-service arrangement. The arrangement, however, contains provisions for additional bonus to the physicians or reimbursement from the physicians based upon cost and quality factors. We often refer to these arrangements as Model 1 contracts.

We work with physicians to help them operate efficiently by providing financial and utilization information, physician and patient educational programs and disease and medical management programs. Our programs are also designed to help the physicians coordinate care outside of their offices. In addition, we are governed by state prompt payment policies.

We believe our collaborative approach with physicians gives us a competitive advantage in entering new markets. Our physicians serve on local committees that assist us in implementing preventive care programs,



managing costs and improving the overall quality of care delivered to our members, while also simplifying the administrative burdens on our providers. This approach has enabled us to strengthen our provider networks through improved physician recruitment and retention that, in turn, have helped to increase our membership base. The following are among the services we provide to support physicians:

- *Customized Utilization Reports* provide certain of our contracted physicians with information that enables them to run their practices more efficiently and focuses them on specific patient needs. For example, quarterly detail reports update physicians on their status within their risk pools. Equivalency reports provide physicians with financial comparisons of capitated versus fee-for-service arrangements.
- *Case Management Support* helps the physician coordinate specialty care and ancillary services for patients with complex conditions and direct members to appropriate community resources to address both their health and socio-economic needs.
- *Web-based Claims and Eligibility Resources* have been implemented in selected markets to provide physicians with on-line access to perform claims and eligibility inquiries.

Our contracted physicians also benefit from several of the services offered to our members, including the CONNECTIONS, EPSDT case management and health management programs. For example, the CONNECTIONS staff facilitates doctor/patient relationships by connecting members with physicians, the EPSDT programs encourage routine checkups for children with their physicians and the health management programs assist physicians in managing their patients with chronic disease.

Where appropriate, our health plans contract with our specialty services organizations to provide services and programs such as behavioral health, health management, managed vision, nurse triage, pharmacy benefit management, and treatment compliance. When necessary, we also contract with third-party providers on a negotiated fee arrangement for physical therapy, home healthcare, diagnostic laboratory tests, x-ray examinations, ambulance services and durable medical equipment. Additionally, we contract with dental vendors in markets where routine dental care is a covered benefit.

### **Quality Management**

Our medical management programs focus on improving quality of care in areas that have the greatest impact on our members. We employ strategies, including health management and complex case management, that are adjusted for implementation in our individual markets by a system of physician committees chaired by local physician leaders. This process promotes physician participation and support, both critical factors in the success of any clinical quality improvement program.

We have implemented specialized information systems to support our medical quality management activities. Information is drawn from our data warehouse, clinical databases and our membership and claims processing system, to identify opportunities to improve care and to track the outcomes of the interventions implemented to achieve those improvements. Some examples of these intervention programs include:

- Smart Start For Your Baby, a prenatal case management program aimed at helping women with high-risk pregnancies deliver full-term, healthy infants;
- an emergency room diversion program to reduce the number of inappropriate emergency room visits; and
- a health management program to improve the ability of those with asthma and their families to control their disease and thereby reduce the need for emergency room visits and hospitalizations.

We provide reporting on a regular basis using our data warehouse. State and Health Employer Data and Information Set, or HEDIS, reporting constitutes the core of the information base that drives our clinical quality performance efforts. This reporting is monitored by Plan Quality Improvement Committees and our corporate medical management team.

In an effort to ensure the quality of our provider networks, we undertake to verify the credentials and background of our providers using standards that are supported by the National Committee for Quality Assurance.

### **Information Technology**

The ability to access data and translate it into meaningful information is essential to operating across a multi-state service area in a cost-effective manner. Our centralized information systems which are located in St. Louis, Missouri, support our core processing functions under a set of integrated databases and are designed to be both replicable and scalable to accommodate organic growth and growth from acquisitions. We believe we have the ability to leverage the platform we have developed for our existing states for configuration into new states or health plan acquisitions.

Our integrated approach helps to assure that consistent sources of claim and member information are provided across all of our health plans. Our membership and claims processing system is capable of expanding to support additional members in an efficient manner. We have a disaster recovery and business resumption plan developed and implemented in conjunction with a third party. This plan allows us complete access to the business resumption centers and hot-site facilities provided by the plan.

### **SPECIALTY SERVICES**

Our Specialty Services segment is a key component of our healthcare enterprise and complements our core Medicaid Managed Care business. The specialty services diversify our revenue stream, provide higher quality health outcomes to our membership and others, and assist in controlling costs. Our specialty services are provided primarily through the following businesses:

- ***Behavioral Health.*** Cenpatico Behavioral Health manages behavioral healthcare for members via a contracted network of providers. Cenpatico works with providers to determine the best course of treatment for a given diagnosis and helps ensure members and their providers are aware of the full array of services available. Our networks feature a range of services so that patients can be treated at an appropriate level of care. We also run school-based programs in Arizona that focus on students with special needs. We acquired Cenpatico in 2003.
- ***Life and Health Management.*** Our life and health management company, Nurtur Health (formerly AirLogix, Cardium Health and Work/Life Innovations), specializes in implementing life and health management programs that encourage healthy behaviors, promote healthier workplaces, improve productivity and reduce healthcare costs. Specific focuses include chronic respiratory health management, cardiac health management, and work/life management. Through its specialization in respiratory management, Nurtur Health uses self-care therapies, in-home interaction and informatics processes to deliver highly effective clinical results, enhanced patient-provider satisfaction and greater cost reductions in respiratory management. Through a people centered, multi-disciplinary and integrated approach, Nurtur Health also uses primary health coaches, customized care plans, and disease-specific education to assist patients in achieving their health goals and deliver enhanced patient-provider satisfaction and greater cost reductions in chronic life and health management. We acquired AirLogix in July 2005, Cardium Health in May 2006 and Work/Life Innovations in November 2007. The combination of these three entities was completed in December 2007.
- ***Long-term Care.*** Bridgeway Health Solutions provides long-term care services to the elderly and people with disabilities on SSI that meet income and resources requirements who are at risk of being or are institutionalized. Bridgeway has members in the Maricopa, Yuma and La Paz counties of Arizona. Bridgeway attempts to distinguish itself from other Medicaid and Medicare health plans through ongoing participation with community groups to address situations that might be barriers to quality care and independent living. Bridgeway commenced operations in October 2006.
- ***Managed Vision.*** OptiCare manages vision benefits for members via a contracted network of providers. OptiCare works with providers to provide a variety of vision plan designs and helps ensure

members and their providers are aware of the full array of products and services available. Our networks feature a range of products and services so that patients can be treated at an appropriate level of care. We acquired the managed vision business of OptiCare Health Systems, Inc. in July 2006.

- *Nurse Triage.* NurseWise provides a toll-free nurse triage line 24 hours per day, 7 days per week, 52 weeks per year. Our members call one number and reach bilingual customer service representatives and nursing staff who provide health education, triage advice and offer continuous access to health plan functions. Additionally, our representatives verify eligibility, confirm primary care provider assignments and provide benefit and network referral coordination for members and providers after business hours. Our staff can arrange for urgent pharmacy refills, transportation and qualified behavioral health professionals for crisis stabilization assessments. Call volume is based on membership levels and seasonal variation. NurseWise operates in certain areas under the name Nurse Response. NurseWise commenced operations in 1998.
- *Pharmacy Benefits Management.* US Script is a pharmacy benefits manager that administers pharmacy benefits and processes pharmacy claims via its proprietary claims processing software. US Script has developed and administers a contracted national network of retail pharmacies. We acquired US Script in January 2006.
- *Treatment Compliance.* ScriptAssist is a treatment compliance program that uses psychological-based tools to predict which patients are likely to be non-compliant regarding taking their medications, and then to motivate those at-risk patients to adhere to their doctors' advice. ScriptAssist uses registered nurses to educate patients about the reasons for the medications they were prescribed, to provide accurate information about side effects and risks of such medications, and to keep the doctors informed of the patients' progress between visits. We acquired ScriptAssist in 2003.

## CORPORATE COMPLIANCE

Our Corporate Ethics and Compliance Program was first established in 1998 and provides methods by which we further enhance operations, safeguard against fraud and abuse, improve access to quality care and helps assure that our values are reflected in everything we do.

The two primary standards by which corporate compliance programs in the healthcare industry are measured are the 1991 Federal Organizational Sentencing Guidelines and the "Compliance Program Guidance" series issued by the Office of the Inspector General, or OIG, of the Department of Health and Human Services. Our program contains each of the seven elements suggested by the Sentencing Guidelines and the OIG guidance. These key components are:

- written standards of conduct;
- designation of a corporate compliance officer and compliance committee;
- effective training and education;
- effective lines for reporting and communication;
- enforcement of standards through disciplinary guidelines and actions;
- internal monitoring and auditing; and
- prompt response to detected offenses and development of corrective action plans.

Our internal Corporate Compliance website, accessible by all employees, contains our Business Ethics and Conduct Policy, our Mission, Values and Philosophies and Compliance Programs, a company-wide policy and procedure database and our toll-free hotline to allow employees or other persons to report suspected incidents of fraud, abuse or other violations. The audit committee and the board of directors review a compliance report on a quarterly basis.

## COMPETITION

We continue to face varying and increasing levels of competition as we expand in our existing service areas or enter new markets, as federal regulations require at least two competitors in each service area. Healthcare reform proposals may cause a number of commercial managed care organizations to decide to enter or exit the Medicaid market.

In our business, our principal competitors for state contracts, members and providers consist of the following types of organizations:

- *Medicaid Managed Care Organizations* focus on providing healthcare services to Medicaid recipients. These organizations consist of national and regional organizations, as well as smaller organizations that operate in one city or state and are owned by providers, primarily hospitals.
- *National and Regional Commercial Managed Care Organizations* have Medicaid members in addition to members in private commercial plans. Some of these organizations offer a range of specialty services including pharmacy benefits management, behavioral health management, health management, and nurse triage call support centers.
- *Primary Care Case Management Programs* are programs established by the states through contracts with primary care providers. Under these programs, physicians provide primary care services to Medicaid recipients, as well as limited medical management oversight.

We compete with other managed care organizations and specialty companies for state contracts. In order to grant a contract, state governments consider many factors. These factors include quality of care, financial requirements, an ability to deliver services and establish provider networks and infrastructure. In addition, our specialty companies also compete with other providers, such as disease management companies and pharmacy benefits managers for non-governmental contracts.

We also compete to enroll new members and retain existing members. People who wish to enroll in a managed healthcare plan or to change healthcare plans typically choose a plan based on the quality of care and services offered, ease of access to services, a specific provider being part of the network and the availability of supplemental benefits. In certain markets, where recipients select a physician instead of a health plan, we are able to grow our membership by adding new physicians to our provider base.

We also compete with other managed care organizations to enter into contracts with physicians, physician groups and other providers. We believe the factors that providers consider in deciding whether to contract with us include existing and potential member volume, reimbursement rates, medical management programs, speed of reimbursement and administrative service capabilities. See "Risk Factors — Competition may limit our ability to increase penetration of the markets that we serve."

## REGULATION

Our healthcare and specialty operations are regulated at both state and federal levels. Government regulation of the provision of healthcare products and services is a changing area of law that varies from jurisdiction to jurisdiction. Regulatory agencies generally have discretion to issue regulations and interpret and enforce laws and rules. Changes in applicable laws and rules also may occur periodically.

Our regulated subsidiaries are licensed to operate as health maintenance organizations and/or insurance companies in their respective states. In each of the jurisdictions in which we operate, we are regulated by the relevant health, insurance and/or human services departments that oversee the activities of managed care organizations providing or arranging to provide services to Medicaid enrollees.

The process for obtaining authorization to operate as a managed care organization is complex and requires demonstration to the regulators of the adequacy of the health plan's organizational structure, financial resources, utilization review, quality assurance programs, complaint procedures, provider network adequacy and procedures for covering emergency medical conditions. Under both state managed care organization statutes and state insurance laws, our health plan subsidiaries must comply with minimum statutory capital

requirements and other financial requirements, such as deposit and reserve requirements. Insurance regulations may also require prior state approval of acquisitions of other managed care organizations' businesses and the payment of dividends, as well as notice for loans or the transfer of funds. Our subsidiaries are also subject to periodic reporting requirements. In addition, each health plan must meet criteria to secure the approval of state regulatory authorities before implementing operational changes, including the development of new product offerings and, in some states, the expansion of service areas.

States have adopted a number of regulations that may affect our business and results of operations. These regulations in certain states include:

- premium and maintenance taxes;
- stringent prompt-pay laws;
- requirements of National Provider Identifier numbers on claim submittals;
- disclosure requirements regarding provider fee schedules and coding procedures; and
- programs to monitor and supervise the activities and financial solvency of provider groups.

### State Contracts

In order to be a Medicaid Managed Care organization in each of the states in which we operate, we must operate under a contract with the state's Medicaid agency. States generally use either a formal proposal process, reviewing a number of bidders, or award individual contracts to qualified applicants that apply for entry to the program. We receive monthly payments based on specified capitation rates determined on an actuarial basis. These rates differ by membership category and by state depending on the specific benefits and policies adopted by each state.

Our contracts with the states and regulatory provisions applicable to us generally set forth the requirements for operating in the Medicaid sector, including provisions relating to:

- eligibility, enrollment and disenrollment processes;
- covered services;
- eligible providers;
- subcontractors;
- record-keeping and record retention;
- periodic financial and informational reporting;
- quality assurance;
- health education and wellness and prevention programs;
- timeliness of claims payment;
- financial standards;
- safeguarding of member information;
- fraud and abuse detection and reporting;
- grievance procedures; and
- organization and administrative systems.

A health plan's compliance with these requirements is subject to monitoring by state regulators and by CMS. A health plan is also subject to periodic comprehensive quality assurance evaluations by a third-party reviewing organization and generally by the insurance department of the jurisdiction that licenses the health plan. A health plan must also submit reports to various regulatory agencies, including quarterly and annual statutory financial statements and utilization reports.

The table below sets forth the term of our state contracts and provides details regarding related renewal or extension and termination provisions as of December 31, 2007.

<b>State Contract</b>	<b>Expiration Date</b>	<b>Renewal or Extension by the State</b>	<b>Termination by the State</b>
Arizona – Behavioral Health	June 30, 2008	May be extended for up to two additional years.	May be terminated for convenience or an event of default.
Arizona – Long-term Care	September 30, 2009	May be extended for up to two additional years.	May be terminated for convenience, an event of default or lack of funding.
Arizona – Special Needs Plan (Medicare)	December 31, 2008	Renewable annually for successive 12-month periods.	May be terminated by an event of default.
Georgia – Medicaid & SCHIP	June 30, 2008	Renewable for four additional one-year terms.	May be terminated for an event of default or significant changes in circumstances.
Indiana – Medicaid & SCHIP	December 31, 2010	May be extended for up to two additional years.	May be terminated for convenience or an event of default.
Kansas – Behavioral Health	June 30, 2009	May be extended with three one-year renewal options.	May be terminated for cause, or without cause for lack of funding.
New Jersey – Medicaid, SCHIP & SSI	June 30, 2008	Renewable annually for successive 12-month periods.	May be terminated for convenience or an event of default.
Ohio – Medicaid & SCHIP	June 30, 2008	Renewable annually for successive 12-month periods.	May be terminated for an event of default.
Ohio – Aged, Blind or Disabled (SSI)	June 30, 2008	Renewable annually for successive 12-month periods.	May be terminated for an event of default.
Ohio – Special Needs Plan (Medicare)	December 31, 2008	Renewable annually for successive 12-month periods.	May be terminated by an event of default.
South Carolina – Medicaid & SSI	March 31, 2008	Renewable annually for successive 12-month periods.	May be terminated for convenience or an event of default.
Texas – Medicaid, SCHIP & SSI	August 31, 2008	May be extended for up to six additional years.	May be terminated for convenience, an event of default or lack of federal funding.
Texas – Exclusive Provider Organization (SCHIP)	August 31, 2008	May be extended for up to two additional years.	May be terminated upon any event of default or in the event of lack of state or federal funding.
Texas – Foster Care	August 31, 2010	May be extended for up to five and a half additional years.	May be terminated for convenience, an event of default, or non-appropriation of funds.
Texas – Special Needs Plan (Medicare)	December 31, 2008	Renewable annually for successive 12-month periods.	May be terminated by an event of default.

Wisconsin – Medicaid & SSI	December 31, 2009	May be extended for up to one additional year.	May be terminated if a change in state or federal laws, rules or regulations materially affects either party's right or responsibilities or for an event of default or lack of funding.
Wisconsin – Network Health Plan Subcontract	December 31, 2011	Renews automatically for successive five-year terms.	May be terminated upon two-years notice prior to the end of the then current term or if a change in state or federal laws, rules or regulations materially affects either party's rights or responsibilities under the contract, or if Network Health Plan's contract with the State is terminated.
Wisconsin – Special Needs Plan (Medicare)	December 31, 2008	Renewable annually for successive 12-month periods.	May be terminated by an event of default.

## HIPAA

In 1996, Congress enacted the Health Insurance Portability and Accountability Act of 1996, or HIPAA. The Act is designed to improve the portability and continuity of health insurance coverage and simplify the administration of health insurance claims. Among the main requirements of HIPAA are standards for the processing of health insurance claims and related transactions.

The regulation's requirements apply to transactions conducted using "electronic media." Since "electronic media" is defined broadly to include "transmissions that are physically moved from one location to another using magnetic tape, disk or compact disk media," many communications are considered to be electronically transmitted. Under the HIPAA regulations, health plans are required to have the capacity to accept and send all covered transactions in a standardized electronic format. Penalties can be imposed for failure to comply with these requirements.

HIPAA regulations also protect the privacy of medical records and other personal health information maintained and used by healthcare providers, health plans and healthcare clearinghouses. We have implemented processes, policies and procedures to comply with the HIPAA privacy regulations, including education and training for employees. In addition, the corporate privacy officer and health plan privacy officials serve as resources to employees to address any questions or concerns they may have. Among numerous other requirements, the privacy regulations:

- limit certain uses and disclosures of private health information, and require patient authorizations for such uses and disclosures of private health information;
- guarantee patients rights to access their medical records and to know who else has accessed them;
- limit most disclosure of health information to the minimum needed for the intended purpose;
- establish procedures to ensure the protection of private health information;
- authorize access to records by researchers and others; and
- impose criminal and civil sanctions for improper uses or disclosures of health information.

The preemption provisions of HIPAA provide that the federal standards will not preempt state laws that are more stringent than the related federal requirements. In addition, the Secretary of HHS may grant

exceptions allowing state laws to prevail if one or more of a number of conditions are met, including but not limited to the following:

- the state law is necessary to prevent fraud and abuse associated with the provision of and payment for healthcare;
- the state law is necessary to ensure appropriate state regulation of insurance and health plans;
- the state law is necessary for state reporting on healthcare delivery or costs; or
- the state law addresses controlled substances.

In 2003, HHS published final regulations relating to the security of electronic individually identifiable health information. Compliance with these regulations was required by April 2005. These regulations require healthcare providers, health plans and healthcare clearinghouses to implement administrative, physical and technical safeguards to ensure the privacy and confidentiality of such information when it is electronically stored, maintained or transmitted through such devices as user authentication mechanisms and system activity audits. In addition, numerous states have adopted personal data security laws that provide for, among other things, private rights of action for breaches of data security and mandatory notification to persons whose identifiable information is obtained without authorization.

### **Patients' Rights Legislation**

The United States Senate and House of Representatives passed different versions of patients' rights legislation in 2001. Both versions included provisions that specifically apply protections to participants in federal healthcare programs, including Medicaid beneficiaries. Although no such federal legislation has been enacted, patients' rights legislation is frequently proposed in Congress. If enacted, this type of legislation could expand our potential exposure to lawsuits and increase our regulatory compliance costs. Depending on the final form of any enacted patients' rights legislation, such legislation could, among other things, expose us to liability for economic and punitive damages for making determinations that deny benefits or delay beneficiaries' receipt of benefits as a result of our medical necessity or other coverage determinations. We cannot predict when or whether patients' rights legislation will be enacted into law or, if enacted, what final form such legislation might take.

### **Other Fraud and Abuse Laws**

Investigating and prosecuting healthcare fraud and abuse became a top priority for law enforcement entities in the last decade. The focus of these efforts has been directed at participants in public government healthcare programs such as Medicaid. The laws and regulations relating to Medicaid fraud and abuse and the contractual requirements applicable to health plans participating in these programs are complex and changing and may require substantial resources.

## **EMPLOYEES**

As of December 31, 2007, we had approximately 3,100 employees. Our employees are not represented by a union. We believe our relationships with our employees are good.



## EXECUTIVE OFFICERS

The following table sets forth information regarding our executive officers, including their ages at January 31, 2008:

Name	Age	Position
Michael F. Neidorff	65	Chairman and Chief Executive Officer
Mark W. Eggert	46	Executive Vice President, Health Plan Business Unit
Carol E. Goldman	50	Executive Vice President and Chief Administrative Officer
Cary D. Hobbs	40	Senior Vice President, Strategy and Business Implementation
Jesse N. Hunter	32	Senior Vice President, Corporate Development
Edmund E. Kroll	48	Senior Vice President, Finance and Investor Relations
William N. Scheffel	54	Executive Vice President, Specialty Business Unit
Eric R. Slusser	47	Executive Vice President, Chief Financial Officer and Treasurer
Keith H. Williamson	55	Senior Vice President, General Counsel and Secretary

*Michael F. Neidorff.* Mr. Neidorff has served as our Chairman and Chief Executive Officer since May 2004. From May 1996 to May 2004, Mr. Neidorff served as President, Chief Executive Officer and as a member of our board of directors. From 1995 to 1996, Mr. Neidorff served as a Regional Vice President of Coventry Corporation, a publicly-traded managed care organization, and as the President and Chief Executive Officer of one of its subsidiaries, Group Health Plan, Inc. From 1985 to 1995, Mr. Neidorff served as the President and Chief Executive Officer of Physicians Health Plan of Greater St. Louis, a subsidiary of United Healthcare Corp., a publicly-traded managed care organization now known as UnitedHealth Group Incorporated. Mr. Neidorff also serves as a director of Brown Shoe Company, Inc., a publicly-traded footwear company with global operations.

*Mark W. Eggert.* Mr. Eggert has served as our Executive Vice President, Health Plans since November 2007. From January 1999 to November 2007, Mr. Eggert served as the Associate Vice Chancellor and Deputy General Counsel at Washington University, where he oversaw the legal affairs of the School of Medicine.

*Carol E. Goldman.* Ms. Goldman has served as Executive Vice President, Chief Administrative Officer since June 2007. From July 2002 to June 2007, she served as our Senior Vice President, Chief Administrative Officer. From September 2001 to July 2002, Ms. Goldman served as our Plan Director of Human Resources. From 1998 to August 2001, Ms. Goldman was Human Resources Manager at Mallinckrodt Inc., a medical device and pharmaceutical company.

*Cary D. Hobbs.* Ms. Hobbs has served as our Senior Vice President of Strategy and Business Implementation since January 2004. She served as our Vice President of Strategy and Business Implementation from September 2002 to January 2004 and as our Director of Business Implementation from 1997 to August 2002.

*Jesse N. Hunter.* Mr. Hunter has served as our Senior Vice President, Corporate Development since April 2007. He served as our Vice President, Corporate Development from December 2006 to April 2007. From October 2004 to December 2006, he served as our Vice President, Mergers & Acquisitions. From July 2003 until October 2004, he served as the Director of Mergers & Acquisitions and from February 2002 until July 2003, he served as the Manager of Mergers & Acquisitions.

*Edmund E. Kroll.* Mr. Kroll has served as our Senior Vice President, Finance and Investor Relations since May 2007. From June 1997 to November 2006, Mr. Kroll served as Managing Director at Cowen and Company LLC, where his research coverage focused on the managed care industry, including the Company.

*William N. Scheffel.* Mr. Scheffel has served as our Executive Vice President, Specialty Business Unit since June 2007. From May 2005 to June 2007, he served as our Senior Vice President, Specialty Business Unit. From December 2003 until May 2005, he served as our Senior Vice President and Controller. From July 2002 to October 2003, Mr. Scheffel was a partner with Ernst & Young LLP. From 1975 to July 2002, Mr. Scheffel was with Arthur Andersen LLP.

*Eric R. Slusser.* Mr. Slusser has served as our Executive Vice President and Chief Financial Officer since July 2007 and as our Treasurer since February 2008. Mr. Slusser served as Executive Vice President of Finance, Chief Accounting Officer and Controller of Cardinal Health, Inc. from May 2006 to July 2007 and as Senior Vice President, Chief Accounting Officer and Controller of Cardinal Health, Inc. from May 2005 to May 2006. Mr. Slusser served as Senior Vice President-Chief Accounting Officer and Controller for MCI, Inc. from November 2003 to May 2005, as Corporate Controller for AES (an electric power generation and transmission company) from May 2003 to November 2003, and as Vice President-Controller from January 1996 to May 2003 for Sprint PCS.

*Keith H. Williamson.* Mr. Williamson has served as our Senior Vice President, General Counsel since November 2006 and as our Secretary since February 2007. From 1988 until November 2006, he served at Pitney Bowes Inc. in various legal and executive roles, the last seven years as a Division President. Mr. Williamson also serves as a director of PPL Corporation, a publicly-traded energy and utility holding company.

Information concerning our executive officers' compliance with Section 16(a) of the Securities Exchange Act will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Section 16(a) Beneficial Ownership Reporting Compliance." These portions of our Proxy Statement are incorporated herein by reference. Information concerning our audit committee financial expert and identification of our audit committee will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Information about Corporate Governance." Information concerning our code of ethics will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Code of Business Conduct and Ethics."

#### **Item 1A. Risk Factors**

You should carefully consider the risks described below before making an investment decision. The trading price of our common stock could decline due to any of these risks, in which case you could lose all or part of your investment. You should also refer to the other information in this filing, including our consolidated financial statements and related notes. The risks and uncertainties described below are those that we currently believe may materially affect our Company. Additional risks and uncertainties that we are unaware of or that we currently deem immaterial also may become important factors that affect our Company.

#### **Risks Related to Being a Regulated Entity**

##### ***Reduction in Medicaid, SCHIP and SSI funding could substantially reduce our profitability.***

Most of our revenues come from Medicaid, SCHIP and SSI premiums. The base premium rate paid by each state differs, depending on a combination of factors such as defined upper payment limits, a member's health status, age, gender, county or region, benefit mix and member eligibility categories. Future levels of Medicaid, SCHIP and SSI funding and premium rates may be affected by continuing government efforts to contain healthcare costs and may further be affected by state and federal budgetary constraints. Additionally, state and federal entities may make changes to the design of their Medicaid programs resulting in the cancellation or modification of these programs.

For example, in August 2007, the Centers for Medicare & Medicaid Services, or CMS, published a final rule regarding the estimation and recovery of improper payments made under Medicaid and SCHIP. This rule requires a CMS contractor to sample selected states each year to estimate improper payments in Medicaid and SCHIP and create national and state specific error rates. States must provide information to measure improper payments in Medicaid and SCHIP for managed care and fee-for-service. Each state will be selected for review once every three years for each program. States are required to repay CMS the federal share of any overpayments identified.

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005 to reduce the size of the federal deficit. The Act reduces federal spending by nearly \$40 billion over 5 years, including a \$5 billion reduction in Medicaid. The Act reduces spending by cutting Medicaid payments for prescription drugs and gives states new power to reduce or reconfigure benefits. This law may also lead to lower Medicaid

reimbursements in some states. The Bush administration's budget proposal for fiscal year 2009 proposes cutting Medicaid funding by \$17.4 billion in funding reductions over five years. States also periodically consider reducing or reallocating the amount of money they spend for Medicaid, SCHIP and SSI. In recent years, the majority of states have implemented measures to restrict Medicaid, SCHIP and SSI costs and eligibility.

Changes to Medicaid, SCHIP and SSI programs could reduce the number of persons enrolled in or eligible for these programs, reduce the amount of reimbursement or payment levels, or increase our administrative or healthcare costs under those programs, all of which could have a negative impact on our business. We believe that reductions in Medicaid, SCHIP and SSI payments could substantially reduce our profitability. Further, our contracts with the states are subject to cancellation by the state after a short notice period in the event of unavailability of state funds.

***If SCHIP is not reauthorized or states face shortfalls, our business could suffer.***

SCHIP was initially authorized for a period of ten years through 2007. In late 2007, Congress passed two separate SCHIP reauthorization bills that would have expanded SCHIP coverage, however President Bush vetoed each of these bills. Since they could not come to agreement on long-term SCHIP reauthorization terms, President Bush and Congress agreed to extend SCHIP funding through March 31, 2009. We cannot be certain that SCHIP will be reauthorized when current funding expires in 2009, and if it is, what changes might be made to the program following reauthorization. There are differing views as to what should be contained in an SCHIP reauthorization bill. It is unclear how and when these differences will be resolved and therefore we cannot predict the impact that reauthorization will have on our business, assuming SCHIP is reauthorized.

States receive matching funds from the federal government to pay for their SCHIP programs, which matching funds have a per state annual cap. Because of funding caps, there is a risk that these states could experience shortfalls in future years, which could have an impact on our ability to receive amounts owed to us from states in which we have SCHIP contracts.

***If any of our state contracts are terminated or are not renewed, our business will suffer.***

We provide managed care programs and selected services to individuals receiving benefits under federal assistance programs, including Medicaid, SCHIP and SSI. We provide those healthcare services under contracts with regulatory entities in the areas in which we operate. Our contracts with various states are generally intended to run for one or two years and may be extended for one or two additional years if the state or its agent elects to do so. Our current contracts are set to expire between March 31, 2008 and December 31, 2010. When our contracts expire, they may be opened for bidding by competing healthcare providers. There is no guarantee that our contracts will be renewed or extended. For example, on August 25, 2006, we received notification from the Kansas Health Policy Authority that FirstGuard Health Plan Kansas, Inc.'s contract with the State would not be renewed or extended, and as a result, our contract ended on December 31, 2006. Further, our contracts with the states are subject to cancellation by the state after a short notice period in the event of unavailability of state funds. Our contracts could also be terminated if we fail to perform in accordance with the standards set by state regulatory agencies. For example, the Indiana contract under which we operate can be terminated by the State without cause. If any of our contracts are terminated, not renewed, or renewed on less favorable terms, our business will suffer, and our operating results may be materially affected.

***If we are unable to participate in SCHIP programs, our growth rate may be limited.***

SCHIP is a federal initiative designed to provide coverage for low-income children not otherwise covered by Medicaid or other insurance programs. The programs vary significantly from state to state. Participation in SCHIP programs is an important part of our growth strategy. If states do not allow us to participate or if we fail to win bids to participate, our growth strategy may be materially and adversely affected.

***Changes in government regulations designed to protect the financial interests of providers and members rather than our investors could force us to change how we operate and could harm our business.***

Our business is extensively regulated by the states in which we operate and by the federal government. The applicable laws and regulations are subject to frequent change and generally are intended to benefit and protect the financial interests of health plan providers and members rather than investors. The enactment of new laws and rules or changes to existing laws and rules or the interpretation of such laws and rules could, among other things:

- force us to restructure our relationships with providers within our network;
- require us to implement additional or different programs and systems;
- mandate minimum medical expense levels as a percentage of premium revenues;
- restrict revenue and enrollment growth;
- require us to develop plans to guard against the financial insolvency of our providers;
- increase our healthcare and administrative costs;
- impose additional capital and reserve requirements; and
- increase or change our liability to members in the event of malpractice by our providers.

For example, Congress has previously considered various forms of patient protection legislation commonly known as the Patients' Bill of Rights and such legislation may be proposed again. We cannot predict the impact of any such legislation, if adopted, on our business.

***Regulations may decrease the profitability of our health plans.***

Certain states have enacted regulations which require us to maintain a minimum health benefits ratio, or establish limits on our profitability. Other states require us to meet certain performance and quality metrics in order to receive our full contractual revenue. In certain circumstances, our plans may be required to pay a rebate to the state in the event profits exceed established levels. These regulatory requirements, changes in these requirements or the adoption of similar requirements by our other regulators may limit our ability to increase our overall profits as a percentage of revenues. Certain states, including but not limited to Georgia, Indiana, New Jersey and Texas have implemented prompt-payment laws and are enforcing penalty provisions for failure to pay claims in a timely manner. Failure to meet these requirements can result in financial fines and penalties. In addition, states may attempt to reduce their contract premium rates if regulators perceive our health benefits ratio as too low. Any of these regulatory actions could harm our operating results. Certain states also impose marketing restrictions on us which may constrain our membership growth and our ability to increase our revenues.

***We face periodic reviews, audits and investigations under our contracts with state government agencies, and these audits could have adverse findings, which may negatively impact our business.***

We contract with various state governmental agencies to provide managed healthcare services. Pursuant to these contracts, we are subject to various reviews, audits and investigations to verify our compliance with the contracts and applicable laws and regulations. Any adverse review, audit or investigation could result in:

- refunding of amounts we have been paid pursuant to our contracts;
- imposition of fines, penalties and other sanctions on us;
- loss of our right to participate in various markets;
- increased difficulty in selling our products and services; and
- loss of one or more of our licenses.

***Failure to comply with government regulations could subject us to civil and criminal penalties.***

Federal and state governments have enacted fraud and abuse laws and other laws to protect patients' privacy and access to healthcare. In some states, we may be subject to regulation by more than one

governmental authority, which may impose overlapping or inconsistent regulations. Violation of these and other laws or regulations governing our operations or the operations of our providers could result in the imposition of civil or criminal penalties, the cancellation of our contracts to provide services, the suspension or revocation of our licenses or our exclusion from participating in the Medicaid, SCHIP and SSI programs. If we were to become subject to these penalties or exclusions as the result of our actions or omissions or our inability to monitor the compliance of our providers, it would negatively affect our ability to operate our business.

The Health Insurance Portability and Accountability Act of 1996, or HIPAA, broadened the scope of fraud and abuse laws applicable to healthcare companies. HIPAA created civil penalties for, among other things, billing for medically unnecessary goods or services. HIPAA established new enforcement mechanisms to combat fraud and abuse, including civil and, in some instances, criminal penalties for failure to comply with specific standards relating to the privacy, security and electronic transmission of most individually identifiable health information. It is possible that Congress may enact additional legislation in the future to increase penalties and to create a private right of action under HIPAA, which could entitle patients to seek monetary damages for violations of the privacy rules.

***We may incur significant costs as a result of compliance with government regulations, and our management will be required to devote time to compliance.***

Many aspects of our business are affected by government laws and regulations. The issuance of new regulations, or judicial or regulatory guidance regarding existing regulations, could require changes to many of the procedures we currently use to conduct our business, which may lead to additional costs that we have not yet identified. We do not know whether, or the extent to which, we will be able to recover from the states our costs of complying with these new regulations. The costs of any such future compliance efforts could have a material adverse effect on our business. We have already expended significant time, effort and financial resources to comply with the privacy and security requirements of HIPAA. We cannot predict whether states will enact stricter laws governing the privacy and security of electronic health information. If any new requirements are enacted at the state or federal level, compliance would likely require additional expenditures and management time.

In addition, the Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the SEC and the New York Stock Exchange, or the NYSE, have imposed various requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel will continue to devote time to these compliance initiatives.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting. In particular, we must perform system and process evaluation and testing of our internal controls over financial reporting to allow management to report on the effectiveness of our internal controls over our financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 requires that we incur substantial accounting expense and expend significant management efforts. Moreover, if we are not able to comply with the requirements of Section 404, or if we or our independent registered public accounting firm identifies deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to sanctions or investigations by the NYSE, SEC or other regulatory authorities, which would require additional financial and management resources.

***Changes in healthcare law and benefits may reduce our profitability.***

Numerous proposals relating to changes in healthcare law have been introduced, some of which have been passed by Congress and the states in which we operate or may operate in the future. Changes in applicable laws and regulations are continually being considered, and interpretations of existing laws and rules may also change from time to time. We are unable to predict what regulatory changes may occur or what

effect any particular change may have on our business. For example, these changes could reduce the number of persons enrolled or eligible to enroll in Medicaid, reduce the reimbursement or payment levels for medical services or reduce benefits included in Medicaid coverage. We are also unable to predict whether new laws or proposals will favor or hinder the growth of managed healthcare in general. Legislation or regulations that require us to change our current manner of operation, benefits provided or our contract arrangements may seriously harm our operations and financial results.

For example, in August 2007 CMS issued guidance that imposes new requirements on states that cover children in families with incomes above 250% of the federal poverty level. Under these new requirements, applicable states must provide assurances to CMS that the state has enrolled at least 95% of the Medicaid and SCHIP eligible children in the state who are in families with incomes below 200% of the federal poverty level in Medicaid or SCHIP and that the number of children insured through private employers has not decreased by more than two percentage points over the prior five year period. Three states in which we have SCHIP contracts, Georgia, New Jersey and Wisconsin, are subject to these new regulations. If they are unable to meet these new requirements, they will be unable to continue to cover children in families with incomes above 250% of the federal poverty level, which would likely decrease our membership in such states. Many states object to these new requirements as unduly burdensome and likely to result in a decrease in the number of children covered by SCHIP, and some states, including New Jersey, are pursuing legal challenges against CMS in relation to these new requirements. CMS expects states to comply with the new requirements within 12 months of the issuance of the guidance. We cannot predict whether legal challenges to the new policy will be successful or whether the reauthorized version of SCHIP will expressly address these new requirements. We cannot predict the impact these requirements will have on our revenue if changes are implemented in states in which we serve SCHIP beneficiaries.

*If a state fails to renew a required federal waiver for mandated Medicaid enrollment into managed care or such application is denied, our membership in that state will likely decrease.*

States may administer Medicaid managed care programs pursuant to demonstration programs or required waivers of federal Medicaid standards. Waivers and demonstration programs are generally approved for two year periods and can be renewed on an ongoing basis if the state applies. We have no control over this renewal process. If a state does not renew such a waiver or demonstration program or the Federal government denies a state's application for renewal, membership in our health plan in the state could decrease and our business could suffer.

*Changes in federal funding mechanisms may reduce our profitability.*

The Bush administration previously proposed a major long-term change in the way Medicaid and SCHIP are funded. The proposal, if adopted, would allow states to elect to receive, instead of federal matching funds, combined Medicaid-SCHIP "allotments" for acute and long-term healthcare for low-income, uninsured persons. Participating states would be given flexibility in designing their own health insurance programs, subject to federally-mandated minimum coverage requirements. It is uncertain whether this proposal will be enacted. Accordingly, it is unknown whether or how many states might elect to participate or how their participation may affect the net amount of funding available for Medicaid and SCHIP programs. If such a proposal is adopted and decreases the number of persons enrolled in Medicaid or SCHIP in the states in which we operate or reduces the volume of healthcare services provided, our growth, operations and financial performance could be adversely affected.

On May 29, 2007, CMS issued a final rule that would reduce states' use of intergovernmental transfers for the states' share of Medicaid program funding. By restricting the use of intergovernmental transfers, this rule may restrict some states' funding for Medicaid, which could adversely affect our growth, operations and financial performance. On May 25, 2007, President Bush signed an Iraq war supplemental spending bill that includes a one-year moratorium on the effectiveness of the final rule. We cannot predict whether the rule will ever be implemented and if it is, what impact it will have on our business.

Recent legislative changes in the Medicare program may also affect our business. For example, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 revised cost-sharing requirements for some beneficiaries and requires states to reimburse the federal Medicare program for costs of prescription drug coverage provided to beneficiaries who are enrolled simultaneously in both the Medicaid and Medicare programs. In its fiscal year 2009 budget proposal, the Bush administration has also proposed to further reduce total federal funding for the Medicaid program by \$17.4 billion over the next five years. These changes may reduce the availability of funding for some states' Medicaid programs, which could adversely affect our growth, operations and financial performance. In addition, the new Medicare prescription drug benefit is interrupting the distribution of prescription drugs to many beneficiaries simultaneously enrolled in both Medicaid and Medicare, prompting several states to pay for prescription drugs on an unbudgeted, emergency basis without any assurance of receiving reimbursement from the federal Medicaid program. These expenses may cause some states to divert funds originally intended for other Medicaid services which could adversely affect our growth, operations and financial performance.

***If state regulatory agencies require a statutory capital level higher than the state regulations, we may be required to make additional capital contributions.***

Our operations are conducted through our wholly owned subsidiaries, which include health maintenance organizations, or HMOs, and managed care organizations, or MCOs. HMOs and MCOs are subject to state regulations that, among other things, require the maintenance of minimum levels of statutory capital, as defined by each state. Additionally, state regulatory agencies may require, at their discretion, individual HMOs to maintain statutory capital levels higher than the state regulations. If this were to occur to one of our subsidiaries, we may be required to make additional capital contributions to the affected subsidiary. Any additional capital contribution made to one of the affected subsidiaries could have a material adverse effect on our liquidity and our ability to grow.

***If state regulators do not approve payments of dividends and distributions by our subsidiaries to us, we may not have sufficient funds to implement our business strategy.***

We principally operate through our health plan subsidiaries. If funds normally available to us become limited in the future, we may need to rely on dividends and distributions from our subsidiaries to fund our operations. These subsidiaries are subject to regulations that limit the amount of dividends and distributions that can be paid to us without prior approval of, or notification to, state regulators. If these regulators were to deny our subsidiaries' request to pay dividends to us, the funds available to us would be limited, which could harm our ability to implement our business strategy.

## **Risks Related to Our Business**

***Ineffectiveness of state-operated systems and subcontractors could adversely affect our business.***

Our health plans rely on other state-operated systems or sub-contractors to qualify, solicit, educate and assign eligible clients into the health plans. The effectiveness of these state operations and sub-contractors can have a material effect on a health plan's enrollment in a particular month or over an extended period. When a state implements new programs to determine eligibility, new processes to assign or enroll eligible clients into health plans, or chooses new contractors, there is an increased potential for an unanticipated impact on the overall number of members assigned into the health plans.

***Failure to accurately predict our medical expenses could negatively affect our reported results.***

Our medical expenses include estimates of medical expenses incurred but not yet reported, or IBNR. We estimate our IBNR medical expenses monthly based on a number of factors. Adjustments, if necessary, are made to medical expenses in the period during which the actual claim costs are ultimately determined or when criteria used to estimate IBNR change. We cannot be sure that our IBNR estimates are adequate or that adjustments to those estimates will not harm our results of operations. For example, in the three months ended June 30, 2006 we adjusted our IBNR by \$9.7 million for adverse medical cost development from the first

quarter of 2006. In addition, when we commence operations in a new state or region, we have limited information with which to estimate our medical claims liabilities. For example, we commenced operations in the Atlanta and Central regions of Georgia on June 1, 2006 and the Southwest region of Georgia on September 1, 2006 and have based our estimates on state provided historical actuarial data and limited actual incurred and received data. From time to time in the past, our actual results have varied from our estimates, particularly in times of significant changes in the number of our members. Our failure to estimate IBNR accurately may also affect our ability to take timely corrective actions, further harming our results.

***Receipt of inadequate or significantly delayed premiums would negatively affect our revenues and profitability.***

Our premium revenues consist of fixed monthly payments per member and supplemental payments for other services such as maternity deliveries. These premiums are fixed by contract, and we are obligated during the contract periods to provide healthcare services as established by the state governments. We use a large portion of our revenues to pay the costs of healthcare services delivered to our members. If premiums do not increase when expenses related to medical services rise, our earnings will be affected negatively. In addition, our actual medical services costs may exceed our estimates, which would cause our health benefits ratio, or our expenses related to medical services as a percentage of premium revenue, to increase and our profits to decline. In addition, it is possible for a state to increase the rates payable to the hospitals without granting a corresponding increase in premiums to us. If this were to occur in one or more of the states in which we operate, our profitability would be harmed. In addition, if there is a significant delay in our receipt of premiums to offset previously incurred health benefits costs, our earnings could be negatively impacted.

***Failure to effectively manage our medical costs or related administrative costs would reduce our profitability.***

Our profitability depends, to a significant degree, on our ability to predict and effectively manage expenses related to health benefits. We have less control over the costs related to medical services than we do over our general and administrative expenses. Because of the narrow margins of our health plan business, relatively small changes in our health benefits ratio can create significant changes in our financial results. Changes in healthcare regulations and practices, the level of use of healthcare services, hospital costs, pharmaceutical costs, major epidemics, new medical technologies and other external factors, including general economic conditions such as inflation levels, are beyond our control and could reduce our ability to predict and effectively control the costs of providing health benefits. We may not be able to manage costs effectively in the future. If our costs related to health benefits increase, our profits could be reduced or we may not remain profitable.

***Difficulties in executing our acquisition strategy could adversely affect our business.***

Historically, the acquisition of Medicaid and specialty services businesses, contract rights and related assets of other health plans both in our existing service areas and in new markets has accounted for a significant amount of our growth. Many of the other potential purchasers have greater financial resources than we have. In addition, many of the sellers are interested either in (a) selling, along with their Medicaid assets, other assets in which we do not have an interest or (b) selling their companies, including their liabilities, as opposed to the assets of their ongoing businesses.

We generally are required to obtain regulatory approval from one or more state agencies when making acquisitions. In the case of an acquisition of a business located in a state in which we do not currently operate, we would be required to obtain the necessary licenses to operate in that state. In addition, even if we already operate in a state in which we acquire a new business, we would be required to obtain additional regulatory approval if the acquisition would result in our operating in an area of the state in which we did not operate previously, and we could be required to renegotiate provider contracts of the acquired business. We cannot assure you that we would be able to comply with these regulatory requirements for an acquisition in a timely manner, or at all. In deciding whether to approve a proposed acquisition, state regulators may consider a



number of factors outside our control, including giving preference to competing offers made by locally owned entities or by not-for-profit entities.

We also may be unable to obtain sufficient additional capital resources for future acquisitions. If we are unable to effectively execute our acquisition strategy, our future growth will suffer and our results of operations could be harmed.

***Execution of our growth strategy may increase costs or liabilities, or create disruptions in our business.***

We pursue acquisitions of other companies or businesses from time to time. Although we review the records of companies or businesses we plan to acquire, even an in-depth review of records may not reveal existing or potential problems or permit us to become familiar enough with a business to assess fully its capabilities and deficiencies. As a result, we may assume unanticipated liabilities or adverse operating conditions, or an acquisition may not perform as well as expected. We face the risk that the returns on acquisitions will not support the expenditures or indebtedness incurred to acquire such businesses, or the capital expenditures needed to develop such businesses. We also face the risk that we will not be able to integrate acquisitions into our existing operations effectively without substantial expense, delay or other operational or financial problems. Integration may be hindered by, among other things, differing procedures, including internal controls, business practices and technology systems. We may need to divert more management resources to integration than we planned, which may adversely affect our ability to pursue other profitable activities.

In addition to the difficulties we may face in identifying and consummating acquisitions, we will also be required to integrate and consolidate any acquired business or assets with our existing operations. This may include the integration of:

- additional personnel who are not familiar with our operations and corporate culture;
- provider networks that may operate on different terms than our existing networks;
- existing members, who may decide to switch to another healthcare plan; and
- disparate administrative, accounting and finance, and information systems.

Additionally, our growth strategy includes start-up operations in new markets or new products in existing markets. We may incur significant expenses prior to commencement of operations and the receipt of revenue. As a result, these start-up operations may decrease our profitability. In the event we pursue any opportunity to diversify our business internationally, we would become subject to additional risks, including, but not limited to, political risk, an unfamiliar regulatory regime, currency exchange risk and exchange controls, cultural and language differences, foreign tax issues, and different labor laws and practices.

Accordingly, we may be unable to identify, consummate and integrate future acquisitions or start-up operations successfully or operate acquired or new businesses profitably.

***If competing managed care programs are unwilling to purchase specialty services from us, we may not be able to successfully implement our strategy of diversifying our business lines.***

We are seeking to diversify our business lines into areas that complement our Medicaid business in order to grow our revenue stream and balance our dependence on Medicaid risk reimbursement. In order to diversify our business, we must succeed in selling the services of our specialty subsidiaries not only to our managed care plans, but to programs operated by third-parties. Some of these third-party programs may compete with us in some markets, and they therefore may be unwilling to purchase specialty services from us. In any event, the offering of these services will require marketing activities that differ significantly from the manner in which we seek to increase revenues from our Medicaid programs. Our inability to market specialty services to other programs may impair our ability to execute our business strategy.

***Failure to achieve timely profitability in any business would negatively affect our results of operations.***

Start-up costs associated with a new business can be substantial. For example, in order to obtain a certificate of authority in most jurisdictions, we must first establish a provider network, have systems in place and demonstrate our ability to obtain a state contract and process claims. If we were unsuccessful in obtaining the necessary license, winning the bid to provide service or attracting members in numbers sufficient to cover our costs, any new business of ours would fail. We also could be obligated by the state to continue to provide services for some period of time without sufficient revenue to cover our ongoing costs or recover start-up costs. The expenses associated with starting up a new business could have a significant impact on our results of operations if we are unable to achieve profitable operations in a timely fashion.

***We derive a majority of our premium revenues from operations in a small number of states, and our operating results would be materially affected by a decrease in premium revenues or profitability in any one of those states.***

Operations in a few states have accounted for most of our premium revenues to date. For example, our Medicaid contract with Kansas, which terminated December 31, 2006, together with our Medicaid contract with Missouri accounted for \$317.0 million in revenue for the year ended December 31, 2006. If we were unable to continue to operate in any of our current states or if our current operations in any portion of one of those states were significantly curtailed, our revenues could decrease materially. Our reliance on operations in a limited number of states could cause our revenue and profitability to change suddenly and unexpectedly depending on legislative or other governmental or regulatory actions and decisions, economic conditions and similar factors in those states. Our inability to continue to operate in any of the states in which we operate would harm our business.

***Competition may limit our ability to increase penetration of the markets that we serve.***

We compete for members principally on the basis of size and quality of provider network, benefits provided and quality of service. We compete with numerous types of competitors, including other health plans and traditional state Medicaid programs that reimburse providers as care is provided. Subject to limited exceptions by federally approved state applications, the federal government requires that there be choices for Medicaid recipients among managed care programs. Voluntary programs and mandated competition may limit our ability to increase our market share.

Some of the health plans with which we compete have greater financial and other resources and offer a broader scope of products than we do. In addition, significant merger and acquisition activity has occurred in the managed care industry, as well as in industries that act as suppliers to us, such as the hospital, physician, pharmaceutical, medical device and health information systems businesses. To the extent that competition intensifies in any market that we serve, our ability to retain or increase members and providers, or maintain or increase our revenue growth, pricing flexibility and control over medical cost trends may be adversely affected.

In addition, in order to increase our membership in the markets we currently serve, we believe that we must continue to develop and implement community-specific products, alliances with key providers and localized outreach and educational programs. If we are unable to develop and implement these initiatives, or if our competitors are more successful than we are in doing so, we may not be able to further penetrate our existing markets.

***If we are unable to maintain relationships with our provider networks, our profitability may be harmed.***

Our profitability depends, in large part, upon our ability to contract favorably with hospitals, physicians and other healthcare providers. Our provider arrangements with our primary care physicians, specialists and hospitals generally may be cancelled by either party without cause upon 90 to 120 days prior written notice. We cannot assure you that we will be able to continue to renew our existing contracts or enter into new contracts enabling us to service our members profitably.

From time to time providers assert or threaten to assert claims seeking to terminate noncancelable agreements due to alleged actions or inactions by us. Even if these allegations represent attempts to avoid or renegotiate contractual terms that have become economically disadvantageous to the providers, it is possible that in the future a provider may pursue such a claim successfully. In addition, we are aware that other managed care organizations have been subject to class action suits by physicians with respect to claim payment procedures, and we may be subject to similar claims. Regardless of whether any claims brought against us are successful or have merit, they will still be time-consuming and costly and could distract our management's attention. As a result, we may incur significant expenses and may be unable to operate our business effectively.

We will be required to establish acceptable provider networks prior to entering new markets. We may be unable to enter into agreements with providers in new markets on a timely basis or under favorable terms. If we are unable to retain our current provider contracts or enter into new provider contracts timely or on favorable terms, our profitability will be harmed.

***We may be unable to attract and retain key personnel.***

We are highly dependent on our ability to attract and retain qualified personnel to operate and expand our business. If we lose one or more members of our senior management team, including our chief executive officer, Michael F. Neidorff, who has been instrumental in developing our business strategy and forging our business relationships, our business and operating results could be harmed. Our ability to replace any departed members of our senior management or other key employees may be difficult and may take an extended period of time because of the limited number of individuals in the Medicaid managed care and specialty services industry with the breadth of skills and experience required to operate and successfully expand a business such as ours. Competition to hire from this limited pool is intense, and we may be unable to hire, train, retain or motivate these personnel.

***Negative publicity regarding the managed care industry may harm our business and operating results.***

The managed care industry has received negative publicity. This publicity has led to increased legislation, regulation, review of industry practices and private litigation in the commercial sector. These factors may adversely affect our ability to market our services, require us to change our services, and increase the regulatory burdens under which we operate. Any of these factors may increase the costs of doing business and adversely affect our operating results.

***Claims relating to medical malpractice could cause us to incur significant expenses.***

Our providers and employees involved in medical care decisions may be subject to medical malpractice claims. In addition, some states, including Texas, have adopted legislation that permits managed care organizations to be held liable for negligent treatment decisions or benefits coverage determinations. Claims of this nature, if successful, could result in substantial damage awards against us and our providers that could exceed the limits of any applicable insurance coverage. Therefore, successful malpractice or tort claims asserted against us, our providers or our employees could adversely affect our financial condition and profitability. Even if any claims brought against us are unsuccessful or without merit, they would still be time consuming and costly and could distract our management's attention. As a result, we may incur significant expenses and may be unable to operate our business effectively.

***Loss of providers due to increased insurance costs could adversely affect our business.***

Our providers routinely purchase insurance to help protect themselves against medical malpractice claims. In recent years, the costs of maintaining commercially reasonable levels of such insurance have increased dramatically, and these costs are expected to increase to even greater levels in the future. As a result of the level of these costs, providers may decide to leave the practice of medicine or to limit their practice to certain areas, which may not address the needs of Medicaid participants. We rely on retaining a sufficient number of providers in order to maintain a certain level of service. If a significant number of our providers exit our

provider networks or the practice of medicine generally, we may be unable to replace them in a timely manner, if at all, and our business could be adversely affected.

***Growth in the number of Medicaid-eligible persons during economic downturns could cause our operating results to suffer if state and federal budgets decrease or do not increase.***

Less favorable economic conditions may cause our membership to increase as more people become eligible to receive Medicaid benefits. During such economic downturns, however, state and federal budgets could decrease, causing states to attempt to cut healthcare programs, benefits and rates. We cannot predict the impact of changes in the United States economic environment or other economic or political events, including acts of terrorism or related military action, on federal or state funding of healthcare programs or on the size of the population eligible for the programs we operate. If federal funding decreases or remains unchanged while our membership increases, our results of operations will suffer.

***Growth in the number of Medicaid-eligible persons may be countercyclical, which could cause our operating results to suffer when general economic conditions are improving.***

Historically, the number of persons eligible to receive Medicaid benefits has increased more rapidly during periods of rising unemployment, corresponding to less favorable general economic conditions. Conversely, this number may grow more slowly or even decline if economic conditions improve. Therefore, improvements in general economic conditions may cause our membership levels to decrease, thereby causing our operating results to suffer, which could lead to decreases in our stock price during periods in which stock prices in general are increasing.

***If we are unable to integrate and manage our information systems effectively, our operations could be disrupted.***

Our operations depend significantly on effective information systems. The information gathered and processed by our information systems assists us in, among other things, monitoring utilization and other cost factors, processing provider claims, and providing data to our regulators. Our providers also depend upon our information systems for membership verifications, claims status and other information.

Our information systems and applications require continual maintenance, upgrading and enhancement to meet our operational needs and regulatory requirements. Moreover, our acquisition activity requires frequent transitions to or from, and the integration of, various information systems. We regularly upgrade and expand our information systems' capabilities. If we experience difficulties with the transition to or from information systems or are unable to properly maintain or expand our information systems, we could suffer, among other things, from operational disruptions, loss of existing members and difficulty in attracting new members, regulatory problems and increases in administrative expenses. In addition, our ability to integrate and manage our information systems may be impaired as the result of events outside our control, including acts of nature, such as earthquakes or fires, or acts of terrorists.

***We rely on the accuracy of eligibility lists provided by state governments. Inaccuracies in those lists would negatively affect our results of operations.***

Premium payments to us are based upon eligibility lists produced by state governments. From time to time, states require us to reimburse them for premiums paid to us based on an eligibility list that a state later discovers contains individuals who are not in fact eligible for a government sponsored program or are eligible for a different premium category or a different program. Alternatively, a state could fail to pay us for members for whom we are entitled to payment. Our results of operations would be adversely affected as a result of such reimbursement to the state if we had made related payments to providers and were unable to recoup such payments from the providers.

*We may not be able to obtain or maintain adequate insurance.*

We maintain liability insurance, subject to limits and deductibles, for claims that could result from providing or failing to provide managed care and related services. These claims could be substantial. We believe that our present insurance coverage and reserves are adequate to cover currently estimated exposures. We cannot assure you that we will be able to obtain adequate insurance coverage in the future at acceptable costs or that we will not incur significant liabilities in excess of policy limits.

*From time to time, we may become involved in costly and time-consuming litigation and other regulatory proceedings, which require significant attention from our management.*

We are a defendant from time to time in lawsuits and regulatory actions relating to our business. Due to the inherent uncertainties of litigation and regulatory proceedings, we cannot accurately predict the ultimate outcome of any such proceedings. An unfavorable outcome could have a material adverse impact on our business and operating results. In addition, regardless of the outcome of any litigation or regulatory proceedings, such proceedings are costly and require significant attention from our management. For example, in 2006, we were named in two securities class action lawsuits. The status of these lawsuits is discussed below under "Item 3. Legal Proceedings." In addition, we may in the future be the target of similar litigation. As with other litigation, securities litigation could be costly and time consuming, require significant attention from our management and could harm our business and operating results.

#### **Item 1B. Unresolved Staff Comments**

None.

#### **Item 2. Properties**

We own our corporate office headquarters building located in St. Louis, Missouri. In September 2007, we announced the signing of a letter of intent to locate our corporate headquarters in downtown St. Louis, Missouri. We are currently negotiating our involvement as a joint venture partner in the entity that will develop the relevant properties. We expect that the other partners will serve as project developers and coordinate the project financing.

We lease claims processing facilities in Missouri and Montana. We generally lease space in the states where our health plans and specialty companies operate. We are required by various insurance and regulatory authorities to have offices in the service areas where we provide benefits. We believe our current facilities are adequate to meet our operational needs for the foreseeable future.

#### **Item 3. Legal Proceedings**

As previously disclosed, two class action lawsuits were filed against us and certain of our officers and directors in the United States District Court for the Eastern District of Missouri, or Eastern District Court. The lawsuits were consolidated on November 2, 2006, and an amended consolidated complaint was filed in the Eastern District Court on January 17, 2007, which we refer to as the Consolidated Lawsuit. The Consolidated Lawsuit alleges, on behalf of purchasers of our common stock from April 25, 2006 through July 17, 2006, that we and certain of our officers and directors violated federal securities laws by issuing a series of materially false statements prior to the announcement of our fiscal 2006 second quarter results. According to the Consolidated Lawsuit, these allegedly materially false statements had the effect of artificially inflating the price of our common stock, which subsequently dropped after the issuance of a press release announcing our preliminary fiscal 2006 second quarter earnings and revised guidance. We filed a motion to dismiss the Consolidated Lawsuit. On June 29, 2007, the motion to dismiss was granted. The plaintiffs have appealed the order of dismissal, and briefing on the appeal has been completed. Oral argument on the appeal has not yet been held. We anticipate receiving a decision on the appeal during 2008.

Additionally, in August 2006, a separate derivative action was filed on behalf of Centene Corporation against us and certain of our officers and directors in the Eastern District Court. Plaintiff purported to bring suit derivatively on behalf of the Company against the Company's directors for breach of fiduciary duties, gross mismanagement and waste of corporate assets by reason of the directors' alleged failure to correct the misstatements alleged in the Consolidated Lawsuit discussed above. The derivative complaint largely repeated the allegations in the Consolidated Lawsuit. Based on discussions that have been held with plaintiff's counsel, it is our understanding that plaintiff did not intend to pursue this action unless the Consolidated Lawsuit proceeded past the dismissal stage. The derivative action has been dismissed.

In addition, we routinely are subjected to legal proceedings in the normal course of business. While the ultimate resolution of such matters is uncertain, we do not expect the results of any of these matters individually, or in the aggregate, to have a material effect on our financial position or results of operations.

**Item 4. *Submission of Matters to a Vote of Security Holders***

None.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Market for Common Stock; Dividends

Our common stock has been traded and quoted on the New York Stock Exchange under the symbol "CNC" since October 16, 2003.

	2007 Stock Price		2006 Stock Price	
	High	Low	High	Low
First Quarter	\$26.66	\$20.68	\$30.26	\$22.70
Second Quarter	24.28	19.35	29.59	22.88
Third Quarter	23.79	17.65	23.87	13.25
Fourth Quarter	27.73	21.26	26.95	16.11

As of February 8, 2008, there were 54 holders of record of our common stock.

We have never declared any cash dividends on our capital stock and currently anticipate that we will retain any future earnings for the development, operation and expansion of our business.

#### Issuer Purchases of Equity Securities

In October 2007, our board of directors extended the previously adopted November 2005 stock repurchase program, authorizing us to repurchase up to four million shares of common stock from time to time on the open market or through privately negotiated transactions. The repurchase program expires October 31, 2008, but we reserve the right to suspend or discontinue the program at any time. We have established a trading plan with a registered broker to repurchase shares under certain market conditions. During the year ended December 31, 2007, we repurchased 467,157 shares at an average price of \$20.42 and an aggregate cost of \$9.5 million. During the year ended December 31, 2007, with the exception of the 3,957 shares footnoted below, we did not repurchase any shares other than through this publicly announced program.

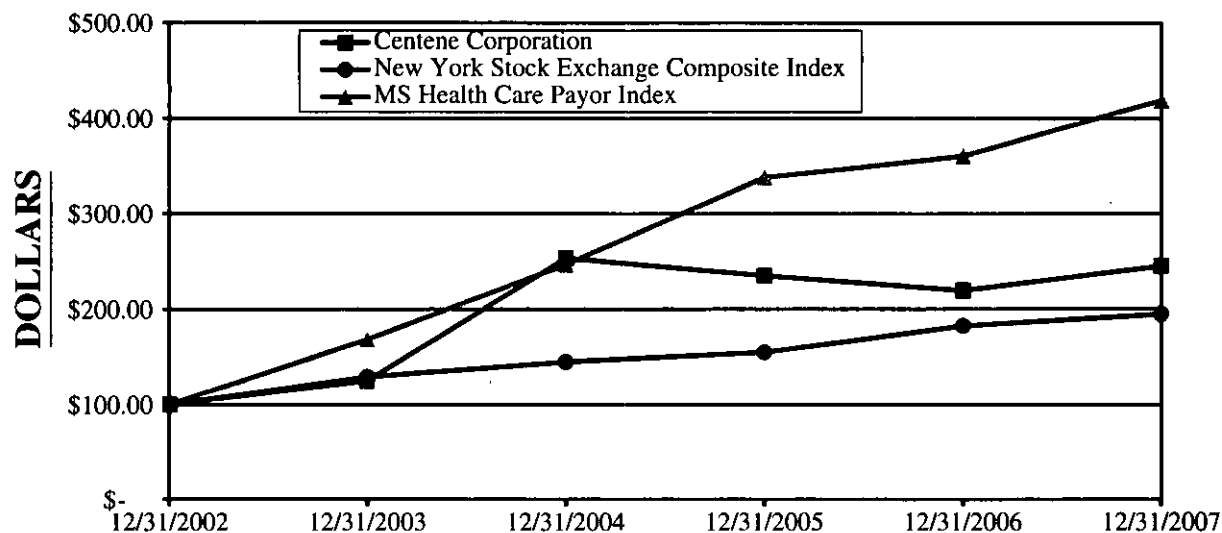
#### Issuer Purchases of Equity Securities Fourth Quarter 2007

Period	Total Number of Shares Purchased	Average Price per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 — October 31, 2007	18,000	\$22.99	18,000	3,159,400
November 1 — November 30, 2007	20,000	22.33	20,000	3,139,400
December 1 — December 31, 2007	3,957 <sup>1</sup>	24.96	—	3,139,400
TOTAL	41,957	\$22.86	38,000	3,139,400

<sup>1</sup> Shares acquired in December 2007 represent shares relinquished to the Company by certain employees for payment of taxes upon vesting of Restricted Stock Units.

### Stock Performance Graphs

The graph below compares the cumulative total stockholder return on our common stock for the period from December 31, 2002 to December 31, 2007 with the cumulative total return of the New York Stock Exchange Composite Index and the Morgan Stanley Health Care Payor Index over the same period. The graph assumes an investment of \$100 on December 31, 2002 in our common stock (at the last reported sale price on such day), the New York Stock Exchange Composite Index and the Morgan Stanley Health Care Payor Index and assumes the reinvestment of any dividends.





## Item 6. Selected Financial Data

The following selected consolidated financial data should be read in connection with the consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this filing. The assets, liabilities and results of operations of FirstGuard have been classified as discontinued operations for all periods presented. The data for the years ended December 31, 2007, 2006 and 2005 and as of December 31, 2007 and 2006 are derived from consolidated financial statements included elsewhere in this filing. The data for the years ended December 31, 2004 and 2003 and as of December 31, 2005, 2004 and 2003 are derived from consolidated financial statements not included in this filing.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except share data)				
<b>Statement of Operations Data:</b>					
Revenues:					
Premium	\$ 2,759,018	\$ 1,844,452	\$ 1,211,023	\$ 965,923	\$ 758,338
Premium tax	79,572	37,961	7,214	5,503	1,425
Service	80,702	79,581	13,965	9,267	9,967
Total revenues	<u>2,919,292</u>	<u>1,961,994</u>	<u>1,232,202</u>	<u>980,693</u>	<u>769,730</u>
Expenses:					
Medical costs	2,324,486	1,555,658	994,517	782,307	626,192
Cost of services	61,454	60,506	5,851	8,065	8,323
General and administrative expenses	399,687	280,067	172,349	121,045	86,863
Premium tax expense	79,572	37,961	7,214	5,503	1,425
Total operating expenses	<u>2,865,199</u>	<u>1,934,192</u>	<u>1,179,931</u>	<u>916,920</u>	<u>722,803</u>
Earnings from operations	54,093	27,802	52,271	63,773	46,927
Other income (expense):					
Investment and other income	25,169	16,416	9,106	6,336	5,160
Interest expense	(15,626)	(10,636)	(3,990)	(680)	(194)
Earnings before income taxes	63,636	33,582	57,387	69,429	51,893
Income tax expense	22,367	12,642	19,686	25,666	19,504
Minority interest	—	—	—	—	881
Net earnings from continuing operations	41,269	20,940	37,701	43,763	33,270
Discontinued operations, net of income tax (benefit) expense of \$(30,899), \$9,335, \$10,538, \$309 and \$0, respectively	32,133	(64,569)	17,931	549	—
Net earnings (loss)	<u>\$ 73,402</u>	<u>\$ (43,629)</u>	<u>\$ 55,632</u>	<u>\$ 44,312</u>	<u>\$ 33,270</u>
Net earnings (loss) per common share:					
Basic:					
Continuing operations	\$ 0.95	\$ 0.49	\$ 0.89	\$ 1.07	\$ 0.93
Discontinued operations	0.74	(1.50)	0.42	0.01	—
Basic earnings (loss) per common share	<u>\$ 1.69</u>	<u>\$ (1.01)</u>	<u>\$ 1.31</u>	<u>\$ 1.09</u>	<u>\$ 0.93</u>
Diluted:					
Continuing operations	\$ 0.92	\$ 0.47	\$ 0.84	\$ 1.00	\$ 0.87
Discontinued operations	0.72	(1.45)	0.40	0.01	—
Diluted earnings (loss) per common share	<u>\$ 1.64</u>	<u>\$ (0.98)</u>	<u>\$ 1.24</u>	<u>\$ 1.02</u>	<u>\$ 0.87</u>
Weighted average number of common shares outstanding:					
Basic	43,539,950	43,160,860	42,312,522	40,820,909	35,704,426
Diluted	44,823,082	44,613,622	45,027,633	43,616,445	38,422,152
	December 31,				
	2007	2006	2005	2004	2003
	(In thousands)				
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 268,584	\$271,047	\$147,358	\$ 84,105	\$ 64,346
Investments and restricted deposits	390,611	197,197	185,697	208,255	220,335
Total assets	1,119,122	894,980	668,030	527,934	362,692
Medical claims liabilities	335,856	249,864	139,687	139,602	106,569
Long-term debt	206,406	174,646	92,448	46,973	7,616
Total stockholders' equity	415,047	326,423	352,048	271,312	220,115

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this filing. The discussion contains forward-looking statements that involve known and unknown risks and uncertainties, including those set forth under Item 1A. Risk Factors of this Form 10-K.*

### **OVERVIEW**

We are a multi-line healthcare enterprise operating in two segments. Our Medicaid Managed Care segment provides Medicaid and Medicaid-related programs to organizations and individuals through government subsidized programs, including Medicaid, the State Children's Health Insurance Program, or SCHIP, and Supplemental Security Income including Aged, Blind or Disabled programs, or SSI. Our Specialty Services segment provides specialty services, including behavioral health, life and health management, long-term care programs, managed vision, nurse triage, pharmacy benefits management and treatment compliance, to state programs, healthcare organizations, employer groups and other commercial organizations, as well as to our own subsidiaries on market-based terms.

Our Medicaid contract in Kansas terminated effective December 31, 2006, and we sold the operating assets of FirstGuard Health Plan, Inc., our Missouri health plan, effective February 1, 2007. Unless specifically noted, the discussions below are in the context of continuing operations, and therefore, exclude the Kansas and Missouri health plans, collectively referred to as FirstGuard, health plans. The results of operations for FirstGuard are classified as discontinued operations for all periods presented.

Our financial performance for 2007 is summarized as follows:

- Year-end Medicaid Managed Care membership of 1,146,600.
- Total revenues of \$2.9 billion.
- Medicaid and SCHIP health benefits ratio, or HBR, of 83.2%, SSI HBR of 92.0%, Specialty Services HBR of 78.2%.
- Medicaid Managed Care general and administrative, or G&A, expense ratio of 11.1% and Specialty Services G&A ratio of 15.4%.
- Diluted net earnings per share from continuing operations of \$0.92.
- Total operating cash flows of \$202.2 million.

Over the last two years we have experienced membership and revenue growth in our Medicaid Managed Care segment including membership growth of 58.7%. The following new contracts and acquisitions contributed to our growth:

- In 2007, we acquired PhyTrust of South Carolina, LLC, or PhyTrust, as well as Physician's Choice, LLC, both of which manage care on a non-risk basis for Medicaid members in South Carolina. At December 31, 2007, our non-risk membership in South Carolina was 31,700 members. We also became licensed in 2007 to provide risk-based managed care in the state and began participating in the transition of the state's conversion to at-risk managed care in December 2007, with 100 members at December 31, 2007.
- In February 2007, we began managing care for SSI recipients in the San Antonio and Corpus Christi markets of Texas with 33,100 members at December 31, 2007.
- In 2007, we began managing care for SSI members in four regions of Ohio, with 20,300 members at December 31, 2007.
- In July 2006, we entered seven new counties in the East Central market of Ohio, and in October 2006, we entered 17 new counties in the Northwest market of Ohio with 41,700 members at December 31, 2007.
- In September 2006, we expanded operations in Texas to include Medicaid and SCHIP members in the Corpus Christi, Austin and Lubbock markets, with 28,900 members at December 31, 2007.

- In Georgia, we began managing care for Medicaid and SCHIP members in the Atlanta and Central regions effective June 1, 2006 and Southwest region effective September 1, 2006. At December 31, 2007, our membership in Georgia was 287,900.

We have opportunities to expand our operations through the following acquisitions and new contract awards:

- In July 2007, we acquired a minority ownership interest in Access Health Solutions, LLC, or Access, which provides managed care for Medicaid recipients in Florida, with 90,600 members at December 31, 2007.
- We have been awarded a contract in Texas for the Children in Foster Care program. This statewide program will provide managed care services to participants in the Texas Foster Care program. The State of Texas has indicated that membership operations are expected to commence April 1, 2008.

The following new contracts and acquisitions contributed to the growth in our Specialty Services segment during the last two years:

- Effective October 1, 2006, we began to provide long-term care services in the Maricopa, Yuma and LaPaz counties in Arizona.
- Effective July 1, 2006, we acquired the managed vision business of OptiCare Managed Vision, Inc., or OptiCare.
- Effective May 9, 2006, we acquired Cadium Health Services Corporation, or Cadium, a health management company.
- Effective January 1, 2006, we acquired US Script, Inc., or US Script, a pharmacy benefits manager (PBM).
- Effective July 22, 2005, we acquired AirLogix, Inc., or AirLogix, a health management provider.
- Effective July 1, 2005, we began to facilitate the delivery of mental health and substance abuse services to behavioral health recipients in Arizona.

## RESULTS OF CONTINUING OPERATIONS AND KEY METRICS

Summarized comparative financial data for 2007, 2006 and 2005 are as follows (\$ in millions):

	2007	2006	2005	% Change 2006-2007	% Change 2005-2006
Premium	\$2,759.0	\$1,844.4	\$1,211.0	49.6%	52.3%
Premium tax	79.6	38.0	7.2	109.6%	426.2%
Service	80.7	79.6	14.0	1.4%	469.9%
Total revenues	2,919.3	1,962.0	1,232.2	48.8%	59.2%
Medical costs	2,324.5	1,555.6	994.5	49.4%	56.4%
Cost of services	61.4	60.5	5.9	1.6%	934.1%
General and administrative expenses	399.7	280.1	172.3	42.7%	62.5%
Premium tax expense	79.6	38.0	7.2	109.6%	426.2%
Earnings from operations	54.1	27.8	52.3	94.6%	(46.8)%
Investment and other income, net	9.6	5.8	5.1	65.1%	13.0%
Earnings before income taxes	63.7	33.6	57.4	89.5%	(41.5)%
Income tax expense	22.4	12.6	19.7	76.9%	(35.8)%
Net earnings from continuing operations	41.3	21.0	37.7	97.1%	(44.5)%
Discontinued operations, net of income tax (benefit) expense of \$(30.9), \$9.3 and \$10.5 respectively	32.1	(64.6)	17.9	(149.8)%	(460.1)%
Net earnings (loss)	\$ 73.4	\$ (43.6)	\$ 55.6	(268.2)%	(178.4)%
Diluted earnings (loss) per common share:					
Continuing operations	\$ 0.92	\$ 0.47	\$ 0.84	95.7%	(44.0)%
Discontinued operations	0.72	(1.45)	0.40	(149.7)%	(462.5)%
Total diluted earnings (loss) per common share	\$ 1.64	\$ (0.98)	\$ 1.24	(267.3)%	(179.0)%

## Revenues and Revenue Recognition

Our Medicaid Managed Care segment generates revenues primarily from premiums we receive from the states in which we operate health plans. We receive a fixed premium per member per month pursuant to our state contracts. We generally receive premium payments during the month we provide services and recognize premium revenue during the period in which we are obligated to provide services to our members. Some states enact premium taxes or similar assessments, collectively, premium taxes, and these taxes are recorded as a component of revenue as well as operating expenses. Some contracts allow for additional premium associated with certain supplemental services provided such as maternity deliveries. Revenues are recorded based on membership and eligibility data provided by the states, which may be adjusted by the states for updates to this data. These adjustments have been immaterial in relation to total revenue recorded and are reflected in the period known.

Our Specialty Services segment generates revenues under contracts with state programs, healthcare organizations, and other commercial organizations, as well as from our own subsidiaries on market-based terms. Revenues are recognized when the related services are provided or as ratably earned over the covered period of services.

Premium and service revenues collected in advance are recorded as unearned revenue. For performance-based contracts, we do not recognize revenue subject to refund until data is sufficient to measure performance. Premium and service revenues due to us are recorded as premium and related receivables and are recorded net of an allowance based on historical trends and our management's judgment on the collectibility of these accounts. As we generally receive payments during the month in which services are provided, the allowance is typically not significant in comparison to total revenues and does not have a material impact on the presentation of our financial condition or results of operations.

Our total revenue increased in the year ended December 31, 2007 over the previous year primarily through 1) membership growth in the Medicaid Managed Care segment, 2) premium rate increases, and 3) growth in our Specialty Services segment.

### I. Membership growth

From December 31, 2005 to December 31, 2007, we increased our Medicaid Managed Care membership by 58.7%. The following table sets forth our membership by state in our Medicaid Managed Care segment:

	December 31,		
	2007	2006	2005
Georgia	287,900	308,800	—
Indiana	154,600	183,100	193,300
New Jersey	57,300	58,900	56,500
Ohio	128,700	109,200	58,700
South Carolina	31,800	—	—
Texas	354,400	298,500	242,000
Wisconsin	131,900	164,800	172,100
Total	<u>1,146,600</u>	<u>1,123,300</u>	<u>722,600</u>

The following table sets forth our membership by line of business in our Medicaid Managed Care segment:

	December 31,		
	2007	2006	2005
Medicaid	848,100	887,300	573,100
SCHIP	224,400	216,200	134,600
SSI	74,100	19,800	14,900
Total	<u>1,146,600</u>	<u>1,123,300</u>	<u>722,600</u>

From December 31, 2006 to December 31, 2007, our membership increased primarily as a result of increases in Ohio, South Carolina and Texas. We increased our Medicaid membership in Ohio by adding members under our new contract in the Northwest region. We also increased our SSI membership in Ohio with the commencement of our new contract to serve Aged, Blind or Disabled members. Our membership in South Carolina is primarily on a non-risk basis; we began conversion to at-risk in December 2007, with 100 at-risk members at December 31, 2007. In Texas, we increased our membership through new Medicaid, SCHIP and SSI contracts in the Corpus Christi, San Antonio, Austin, and Lubbock markets. Our membership decreased in Wisconsin because of more stringent state eligibility requirements for the Medicaid and SCHIP programs, eligibility administration issues and the termination of certain physician contracts associated with a high cost hospital system. Our membership decreased in Indiana primarily due to adjustments made to our provider network made in connection with our new state-wide contract as well as the termination of certain non-exclusive physician contracts. In Florida, Access served 90,600 members on a non-risk basis at December 31, 2007.

During 2006, our subsidiary, Peach State Health Plan, commenced operations in the Atlanta and Central regions of Georgia in June and in the Southwest region in September. We increased our membership in Ohio through the MediPlan acquisition while also adding members under our new contract in the East Central and Northwest markets. In Texas, we increased our membership through new contracts in the Corpus Christi, Austin, and Lubbock markets. Our membership decreased in Wisconsin because of more stringent state eligibility requirements for the Medicaid and SCHIP programs and eligibility administration issues. Our membership decreased in Indiana primarily due to provider terminations.

The total revenue associated with FirstGuard included in results from discontinued operations was \$6.7 million, \$317.0 million and \$273.7 million in 2007, 2006 and 2005, respectively. Our FirstGuard membership was 138,900 and 149,300 at December 31, 2006 and 2005, respectively.

## 2. Premium rate increases

In 2007, we received premium rate increases ranging from 1.9% to 10.1%, or 2.7% on a composite basis across our markets. In 2006, we received premium rate increases ranging from 1.8% to 9.5%, or 5.8% on a composite basis across our markets.

In November 2007, we received a contract amendment from the State of Georgia providing for an effective premium rate increase in Georgia of approximately 3.8% effective July 1, 2007. The state also mandated service changes, retroactively recalculated certain rate cells and adjusted for duplicate member issues. We executed this amendment on November 16, 2007. The State of Georgia returned the fully executed contract in January 2008 and, accordingly, we will record the additional revenue, retroactive to July 1, 2007, in the first quarter of 2008. This revenue, related to the period from July 1, 2007 to December 31, 2007, totals approximately \$20.8 million. Approximately \$7.3 million of this amount is related to the mandated services, rate cell changes and duplicate member issues, the remaining \$13.5 million yields the calculated 3.8% increase.

## 3. Specialty Services segment growth

For the year ended December 31, 2007, Specialty Services segment revenue from external customers was \$245.4 million compared to \$192.0 million for the same prior year period. The increase is primarily

attributable to a full year of operations in 2007 of our acquisition of OptiCare in July 2006 and the commencement of operations of Bridgeway Health Solutions in October 2006. At December 31, 2007, our behavioral health company, Cenpatco, provided behavioral health services to 99,900 members in Arizona and 39,000 members in Kansas, compared to 94,500 members in Arizona and 36,600 members in Kansas at December 31, 2006.

In January 2006, we began offering pharmacy benefits management through our acquisition of US Script, representing most of the 2006 increase in consolidated service revenue. Additionally, in May 2006, we expanded our life and health management services through our acquisition of Cardium. In July 2006, we began offering managed vision care through our acquisition of OptiCare. In October 2006, our subsidiary, Bridgeway Health Solutions began performing under our long-term care contract in Arizona.

## Operating Expenses

### Medical Costs

Our medical costs include payments to physicians, hospitals, and other providers for healthcare and specialty services claims. Medical costs also include estimates of medical expenses incurred but not yet reported, or IBNR, and estimates of the cost to process unpaid claims. Monthly, we estimate our IBNR based on a number of factors, including inpatient hospital utilization data and prior claims experience. As part of this review, we also consider the costs to process medical claims and estimates of amounts to cover uncertainties associated with fluctuations in physician billing patterns, membership, products and inpatient hospital trends. These estimates are adjusted as more information becomes available. We employ actuarial professionals and use the services of independent actuaries who are contracted to review our estimates quarterly. While we believe that our process for estimating IBNR is actuarially sound, we cannot assure you that healthcare claim costs will not materially differ from our estimates.

Our results of operations depend on our ability to manage expenses associated with health benefits and to accurately predict costs incurred. Our health benefits ratio, or HBR, represents medical costs as a percentage of premium revenues (excluding premium taxes) and reflects the direct relationship between the premium received and the medical services provided. The table below depicts our HBR for our external membership by member category:

	Year Ended December 31,		
	2007	2006	2005
Medicaid and SCHIP	83.2%	84.3%	81.5%
SSI	92.0	88.0	98.0
Specialty Services	78.2	82.6	85.0

Our Medicaid and SCHIP HBR for the year ended December 31, 2007 was 83.2%, a decrease of 1.1% over 2006. The decrease is primarily attributable to increased premium yield combined with a moderating medical cost trend particularly with a decrease in retail pharmacy costs.

Our Medicaid and SCHIP HBR for the year ended December 31, 2006 was 84.3%, an increase of 2.8% over 2005. The increase in HBR for the year ended December 31, 2006 is caused primarily by increased cost trends for maternity related costs including neonatal intensive care costs, increased physician costs, and increased pharmacy costs.

The increase in the SSI HBR for the year ended December 31, 2007 is a result of the new SSI business in Ohio and the transition of these new members into a managed care environment.

The decrease in our Specialty Services HBR for year ended December 31, 2007 is caused by the diversification of business in that segment. Our Specialty Services HBR for 2006 includes twelve months of the behavioral health contracts in Arizona and Kansas, six months of OptiCare and three months of Bridgeway. The 2005 results include twelve months of our behavioral health contract in Kansas and six months of Arizona results.

## Cost of Services

Our cost of services expense includes the pharmaceutical costs associated with our pharmacy benefit manager's external revenues. Cost of services also includes all direct costs to support the functions responsible for generation of our services revenues. These expenses consist of the salaries and wages of the professionals and teachers who provide the services and expenses associated with facilities and equipment used to provide services.

## General and Administrative Expenses

Our general and administrative expenses, or G&A, primarily reflect wages and benefits, including stock compensation expense, and other administrative costs associated with our health plans, specialty companies and centralized functions that support all of our business units. Our major centralized functions are finance, information systems and claims processing. G&A increased in the year ended December 31, 2007 over the comparable period in 2006 primarily due to expenses for additional facilities and staff to support our growth. G&A in 2007 also included charges totaling \$12.4 million for fixed asset impairment, severance for an organizational realignment, and a contribution to our charitable foundation with a portion of the proceeds from the sale of FirstGuard Missouri. The fixed asset impairment resulted from abandoning our previously planned headquarters development in Clayton, Missouri. G&A expenses increased in the year ended December 31, 2006 over the comparable period in 2005 primarily due to expenses for additional facilities and staff to support our growth, especially in Arizona and Georgia, and the adoption of SFAS 123R on January 1, 2006. The results for the year ended December 31, 2006, include \$13.9 million of implementation expenses in Georgia and \$9.9 million of additional stock compensation expense.

Our G&A expense ratio represents G&A expenses as a percentage of the sum of Premium revenue and Service revenue, and reflects the relationship between revenues earned and the costs necessary to earn those revenues. The following table sets forth the G&A expense ratios by business segment:

	Year Ended December 31,		
	2007	2006	2005
Medicaid Managed Care	11.1%	11.4%	11.2%
Specialty Services	15.4	17.1	36.6

The decrease in the Medicaid Managed Care G&A expense ratio in 2007 primarily reflects the overall leveraging of our expenses over higher revenues offset by the effect of our start-up costs in South Carolina and for our Texas Foster Care product, and the \$12.4 million charge discussed above. The increase in the Medicaid Managed Care G&A expense ratio in 2006 primarily reflects the adoption of SFAS 123R offset by the overall leveraging of our expenses over higher revenues.

The decrease in the Specialty Services G&A expense ratio in 2007 primarily reflects the overall leveraging of expenses over higher revenues with the additions of Bridgeway and OptiCare, and the growth of US Script's business since the acquisition in January 2006. The 2006 results reflect the operations of our behavioral health company in Arizona, the acquisitions of US Script and AirLogix, as well as the acquisition of Cardium effective May 9, 2006, and OptiCare effective July 1, 2006. The results for the year ended December 31, 2006 include approximately \$0.7 million in implementation costs associated with our long-term care contract in Arizona. The 2005 results reflect the operations of our behavioral health company in Arizona, including \$1.5 million in implementation costs, and \$0.2 million in Georgia implementation costs.

## Other Income (Expense)

Other income (expense) consists principally of investment income from our cash and investments, our equity in earnings of investments, and interest expense on our debt. Investment and other income increased \$8.8 million in 2007, over the comparable periods in 2006. The increase was primarily a result of larger investment balances. Interest expense increased \$5.0 million in 2007, primarily from increased debt.

## **Income Tax Expense**

Our effective tax rate in 2007 was 35.1% compared to 37.6% in 2006. The decrease was primarily due to the effect of an increase in tax-exempt investment income and lower state taxes. Our 2006 effective tax rate was 37.6% compared to 34.3% for the corresponding period in 2005.

## **Discontinued Operations**

Net earnings from discontinued operations were \$32.1 million in 2007 compared to a net loss of \$64.6 million in 2006. In 2007, we abandoned the stock of our FirstGuard health plans resulting in tax benefits of \$32.6 million, net of the associated asset write-offs. The 2007 results also included a gain on the sale of FirstGuard Missouri of \$7.5 million, as well as operational and exit costs associated with FirstGuard. The 2006 results included a goodwill impairment charge of \$81.1 million, an intangible asset impairment charge of \$6.0 million, as well as operational and exit costs.

## **LIQUIDITY AND CAPITAL RESOURCES**

We finance our activities primarily through operating cash flows and borrowings under our revolving credit facility. Our total operating activities provided cash of \$202.2 million in 2007, \$195.0 million in 2006 and \$74.0 million in 2005. Medical claims liabilities increased in 2007 reflecting new business in Ohio and Texas, offset by the payment in 2007 of FirstGuard claims incurred in 2006. The increase in cash flow from operations in 2006 reflects an increase in medical claims liabilities primarily from the commencement of our operations in Georgia and an increase in accounts payable and accrued expenses. Those increases are partially offset by an increase in premium and related receivables in 2006 that reflect an increase in maternity delivery receivables, reimbursements due to us from providers including amounts due under capitated risk-sharing contracts and the inclusion of US Script receivables.

Our investing activities used cash of \$225.5 million in 2007, \$150.3 million in 2006 and \$56.5 million in 2005. Our investing activities in 2007 consisted primarily of additions to the investment portfolios of our regulated subsidiaries including transfers from cash and cash equivalents to long-term investments. During 2006, our investing activities primarily consisted of acquisitions. Our investing activities in 2006 also included additions to the investment portfolios of our regulated subsidiaries. Our investment policies are designed to provide liquidity, preserve capital and maximize total return on invested assets within our investment guidelines. Net cash provided by and used in investing activities will fluctuate from year to year due to the timing of investment purchases, sales and maturities. As of December 31, 2007, our investment portfolio consisted primarily of fixed-income securities with an average duration of 1.9 years. Cash is invested in investment vehicles such as municipal bonds, corporate bonds, instruments of the U.S. Treasury, insurance contracts, commercial paper and equity securities. The states in which we operate prescribe the types of instruments in which our regulated subsidiaries may invest their cash.

We spent \$53.9 million, \$50.3 million and \$26.9 million in 2007, 2006 and 2005, respectively, on capital assets consisting primarily of software and hardware upgrades, and furniture, equipment and leasehold improvements associated with office and market expansions. The expenditures in 2007 included \$36.7 million for computer hardware and software. We anticipate spending approximately \$69 million on capital expenditures in 2008 primarily associated with system enhancements and market expansions.

In September 2007, we announced the signing of a letter of intent to locate our corporate headquarters in downtown St. Louis, Missouri. We are currently negotiating our involvement as a joint venture partner in the entity that will develop the relevant properties. We expect that the other partners will serve as project developers and coordinate the project financing. Our previous redevelopment project in Clayton, Missouri was abandoned in the fourth quarter of 2007 and a charge for real estate impairment was recorded to General and Administrative Expenses, as discussed above.

Our financing activities provided cash of \$20.8 million in 2007, \$78.9 million in 2006 and \$45.7 million in 2005. During 2007, our financing activities primarily related to proceeds from issuance of \$175 million in senior notes as discussed below. During 2006 and 2005, our financing activities primarily were comprised of



proceeds from borrowings under our credit facility. The 2006 borrowings were used primarily for the acquisition of US Script.

At December 31, 2007, we had negative working capital, defined as current assets less current liabilities, of \$(40.5) million, as compared to \$63.9 million at December 31, 2006. Our working capital is negative due to our efforts to increase investment returns through purchases of investments that have maturities of greater than one year and, therefore, are classified as long-term. We manage our short-term and long-term investments with the goal of ensuring that a sufficient portion is held in investments that are highly liquid and can be sold to fund short-term requirements as needed.

Cash, cash equivalents and short-term investments from continuing operations were \$314.9 million at December 31, 2007 and \$310.2 million at December 31, 2006. Long-term investments were \$344.3 million at December 31, 2007 and \$140.4 million at December 31, 2006, including restricted deposits of \$27.3 million and \$24.4 million, respectively. At December 31, 2007, cash and investments held by our unregulated entities totaled \$33.0 million while cash and investments held by our regulated entities totaled \$626.2 million.

We have a \$300 million revolving credit agreement. Borrowings under the agreement bear interest based upon LIBOR rates, the Federal Funds Rate or the Prime Rate. There is a commitment fee on the unused portion of the agreement that ranges from 0.15% to 0.275% depending on the total debt to EBITDA ratio. The agreement contains non-financial and financial covenants, including requirements of minimum fixed charge coverage ratios, maximum debt to EBITDA ratios and minimum net worth. The agreement will expire in September 2011. As of December 31, 2007, we had \$5.0 million in borrowings outstanding under the agreement and \$23.0 million in letters of credit outstanding, leaving availability of \$272.0 million. As of December 31, 2007, we were in compliance with all covenants.

In March 2007, we issued \$175 million aggregate principal amount of our 7¼% Senior Notes due April 1, 2014, or the Notes. In July 2007, the Notes were registered under the Securities Act of 1933, pursuant to a registration rights agreement with the initial purchasers. The indenture governing the Notes contains non-financial and financial covenants, including requiring a minimum fixed charge coverage ratio. Interest is paid semi-annually in April and October. We used a portion of the net proceeds from the offering to refinance approximately \$150.0 million of our existing indebtedness which was outstanding under our revolving credit facility. The additional proceeds will be used for general corporate purposes. As of December 31, 2007, we were in compliance with all covenants.

We have a shelf registration statement on Form S-3 on file with the Securities and Exchange Commission, or the SEC, covering the issuance of up to \$300 million of securities including common stock and debt securities. No securities have been issued under the shelf registration. We may publicly offer securities from time-to-time at prices and terms to be determined at the time of the offering.

We have a stock repurchase program authorizing us to repurchase up to four million shares of common stock from time to time on the open market or through privately negotiated transactions. In October 2007, the repurchase program was extended through October 31, 2008, but we reserve the right to suspend or discontinue the program at any time. During the year ended December 31, 2007, we repurchased 467,157 shares at an average price of \$20.42. We have established a trading plan with a registered broker to repurchase shares under certain market conditions.

During the year ended December 31, 2007, we received dividends of \$35.4 million for the excess regulatory capital remaining in our Kansas and Missouri health plans and dividends of \$18.5 million from other regulated subsidiaries.

Based on our operating plan, we expect that our available cash, cash equivalents and investments, cash from our operations and cash available under our credit facility will be sufficient to finance our operations and capital expenditures for at least 12 months from the date of this filing.

Our contractual obligations at December 31, 2007 consisted of medical claims liabilities, debt, operating leases, purchase obligations and interest on long-term debt. Our debt consists of borrowings from our credit facilities, mortgages and capital leases. The purchase obligations consist primarily of software purchase and

maintenance contracts. The contractual obligations over the next five years and beyond are as follows (in thousands):

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Medical claims liabilities	\$335,856	\$335,856	\$ —	\$ —	\$ —
Debt	207,377	971	20,360	5,509	180,537
Operating leases	132,927	19,046	32,512	24,437	56,932
Purchase obligations	24,432	12,027	12,225	180	—
Interest on long-term debt <sup>1</sup>	82,469	12,688	25,375	25,375	19,031
Total	<u>\$783,061</u>	<u>\$380,588</u>	<u>\$90,472</u>	<u>\$55,501</u>	<u>\$256,500</u>

<sup>1</sup> Interest on \$175,000 Senior Notes.

## REGULATORY CAPITAL AND DIVIDEND RESTRICTIONS

Our Medicaid Managed Care operations are conducted through our subsidiaries. As managed care organizations, these subsidiaries are subject to state regulations that, among other things, require the maintenance of minimum levels of statutory capital, as defined by each state, and restrict the timing, payment and amount of dividends and other distributions that may be paid to us. Generally, the amount of dividend distributions that may be paid by a regulated subsidiary without prior approval by state regulatory authorities is limited based on the entity's level of statutory net income and statutory capital and surplus.

Our subsidiaries are required to maintain minimum capital requirements prescribed by various regulatory authorities in each of the states in which we operate. As of December 31, 2007, our subsidiaries had aggregate statutory capital and surplus of \$302.1 million, compared with the required minimum aggregate statutory capital and surplus requirements of \$192.3 million.

The National Association of Insurance Commissioners has adopted rules which set minimum risk-based capital requirements for insurance companies, managed care organizations and other entities bearing risk for healthcare coverage. As of December 31, 2007, each of our health plans were in compliance with the risk-based capital requirements enacted in those states.

## RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations", or SFAS No. 141R. The purpose of issuing the statement is to replace current guidance in SFAS No. 141 to better represent the economic value of a business combination transaction. The changes to be effected with SFAS No. 141R from the current guidance include, but are not limited to: (1) acquisition costs will be recognized separately from the acquisition; (2) known contractual contingencies at the time of the acquisition will be considered part of the liabilities acquired measured at their fair value; all other contingencies will be part of the liabilities acquired measured at their fair value only if it is more likely than not that they meet the definition of a liability; (3) contingent consideration based on the outcome of future events will be recognized and measured at the time of the acquisition; (4) business combinations achieved in stages (step acquisitions) will need to recognize the identifiable assets and liabilities, as well as noncontrolling interests, in the acquiree, at the full amounts of their fair values; and (5) a bargain purchase (defined as a business combination in which the total acquisition-date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any noncontrolling interest in the acquiree) will require that excess to be recognized as a gain attributable to the acquirer. SFAS No. 141R will be effective for any business combinations that occur after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51", or SFAS No. 160. SFAS No. 160 was issued to improve the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report noncontrolling (minority) interests in subsidiaries in the same way, that is, as equity in the

consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. SFAS No. 160 will be effective January 1, 2009. We are currently evaluating the impact that SFAS No. 160 will have on our financial statements and disclosures.

## CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 2 to our consolidated financial statements included elsewhere herein. Our accounting policies regarding medical claims liabilities and intangible assets are particularly important to the portrayal of our financial position and results of operations and require the application of significant judgment by our management. As a result, they are subject to an inherent degree of uncertainty.

### Medical Claims Liabilities

Our medical claims liabilities include claims reported but not yet paid, or inventory, estimates for claims incurred but not reported, or IBNR, and estimates for the costs necessary to process unpaid claims. We, together with our independent actuaries, estimate medical claims liabilities using actuarial methods that are commonly used by health insurance actuaries and meet Actuarial Standards of Practice. These actuarial methods consider factors such as historical data for payment patterns, cost trends, product mix, seasonality, utilization of healthcare services and other relevant factors. These estimates are continually reviewed each period and adjustments based on actual claim submissions and additional facts and circumstances are reflected in the period known.

Our management uses its judgment to determine the assumptions to be used in the calculation of the required estimates. In developing our estimate for IBNR, we apply various estimation methods depending on the claim type and the period for which claims are being estimated. For more recent periods, incurred non-inpatient claims are estimated based on historical per member per month claims experience adjusted for known factors. Incurred hospital claims are estimated based on authorized days and historical per diem claim experience adjusted for known factors. For older periods, we utilize an estimated completion factor based on our historical experience to develop IBNR estimates. The completion factor is an actuarial estimate of the percentage of claims incurred during a given period that have been adjudicated as of the reporting period to the estimate of the total ultimate incurred costs. When we commence operations in a new state or region, we have limited information with which to estimate our medical claims liabilities. See "Risk Factors — Failure to accurately predict our medical expenses could negatively affect our reported results." These approaches are consistently applied to each period presented.

The completion factor, claims per member per month and per diem cost trend factors are the most significant factors affecting the IBNR estimate. The following table illustrates the sensitivity of these factors and the estimated potential impact on our operating results caused by changes in these factors based on December 31, 2007 data:

Completion Factors (1):		Cost Trend Factors (2):	
(Decrease) Increase in Factors	Increase (Decrease) in Medical Claims Liabilities (In thousands)	(Decrease) Increase in Factors	Increase (Decrease) in Medical Claims Liabilities (In thousands)
(3)%	\$ 54,800	(3)%	\$(14,400)
(2)	36,200	(2)	(9,600)
(1)	17,900	(1)	(4,800)
1	(17,500)	1	4,800
2	(34,700)	2	9,700
3	(51,500)	3	14,700

(1) Reflects estimated potential changes in medical claims liabilities caused by changes in completion factors.

- (2) Reflects estimated potential changes in medical claims liabilities caused by changes in cost trend factors for the most recent periods.

While we believe our estimates are appropriate, it is possible future events could require us to make significant adjustments for revisions to these estimates. For example, a 1% increase or decrease in our estimated medical claims liabilities would have affected net earnings by \$2.1 million for the year ended December 31, 2007. The estimates are based on our historical experience, terms of existing contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate.

The change in medical claims liabilities is summarized as follows (in thousands):

	Year Ended December 31,		
	2007	2006	2005
Balance, January 1	\$ 249,864	\$ 139,687	\$ 139,602
Acquisitions	—	1,788	—
Incurred related to:			
Current year	2,340,716	1,569,082	1,010,656
Prior years	(16,230)	(13,424)	(16,139)
Total incurred	<u>2,324,486</u>	<u>1,555,658</u>	<u>994,517</u>
Paid related to:			
Current year	2,009,881	1,322,607	872,019
Prior years	<u>228,613</u>	<u>124,662</u>	<u>122,413</u>
Total paid	<u>2,238,494</u>	<u>1,447,269</u>	<u>994,432</u>
Balance, December 31	<u>\$ 335,856</u>	<u>\$ 249,864</u>	<u>\$ 139,687</u>
Claims inventory, December 31	312,700	267,700	215,000
Days in claims payable <sup>1</sup>	49.1	46.4	45.0

<sup>1</sup> Days in claims payable is a calculation of medical claims liabilities at the end of the period divided by average expense per calendar day for the fourth quarter of each year.

The acquisition in 2006 includes reserves acquired in connection with our acquisition of OptiCare.

Medical claims are usually paid within a few months of the member receiving service from the physician or other healthcare provider. As a result, these liabilities generally are described as having a "short-tail," which causes less than 5% of our medical claims liabilities as of the end of any given year to be outstanding the following year. Management expects that substantially all the development of the estimate of medical claims liabilities as of December 31, 2007 will be known by the end of 2008.

Actuarial Standards of Practice generally require that medical claims liabilities estimates be adequate to cover obligations under moderately adverse conditions. Moderately adverse conditions are situations in which the actual claims are expected to be higher than the otherwise estimated value of such claims at the time of estimate. In many situations, the claims amounts ultimately settled will be different than the estimate that satisfies the Actuarial Standards of Practice.

Changes in estimates of incurred claims for prior years were attributable to favorable development, including changes in medical utilization and cost trends as well as the effect of establishing the liabilities under moderately adverse conditions. We implement various medical management initiatives in our markets which may contribute to the favorable development of our medical claims liabilities.

#### Intangible Assets

We have made several acquisitions since 2005 that have resulted in our recording of intangible assets. These intangible assets primarily consist of customer relationships, purchased contract rights, provider contracts, trade names and goodwill. At December 31, 2007, we had \$141.0 million of goodwill and

\$13.2 million of other intangible assets. Purchased contract rights are amortized using the straight-line method over periods ranging from five to ten years. Provider contracts are amortized using the straight-line method over periods ranging from five to ten years. Customer relationships are amortized using the straight-line method over periods ranging from five to fifteen years. Trade names are amortized using the straight-line method over 20 years.

Our management evaluates whether events or circumstances have occurred that may affect the estimated useful life or the recoverability of the remaining balance of goodwill and other identifiable intangible assets. If the events or circumstances indicate that the remaining balance of the intangible asset or goodwill may be permanently impaired, the potential impairment will be measured based upon the difference between the carrying amount of the intangible asset or goodwill and the fair value of such asset determined using the estimated future discounted cash flows generated from the use and ultimate disposition of the respective acquired entity. Our management must make assumptions and estimates, such as the discount factor, future utility and other internal and external factors, in determining the estimated fair values. While we believe these assumptions and estimates are appropriate, other assumptions and estimates could be applied and might produce significantly different results.

Goodwill is reviewed every year during the fourth quarter for impairment. In addition, we will perform an impairment analysis of other intangible assets based on other factors. These factors would include significant changes in membership, state funding, medical contracts and provider networks and contracts. In August 2006, FirstGuard Health Plan Kansas, Inc., or FirstGuard Kansas, our wholly owned subsidiary, received notification from the Kansas Health policy Authority that its Medicaid contract scheduled to terminate December 31, 2006 would not be renewed. As a result of these events, we concluded it was necessary to conduct an impairment analysis of the identifiable intangible assets and goodwill of the FirstGuard reporting unit, which encompasses both the Kansas and Missouri FirstGuard health plans.

The fair value of our FirstGuard reporting unit was determined using discounted expected cash flows and estimated market value. The impairment analysis resulted in a total non-cash intangible asset impairment charge of \$87.1 million, consisting of \$81.1 million of goodwill and \$6.0 million of other identifiable intangible assets, which was recorded in discontinued operations in the consolidated statement of operations for the year ended December 31, 2006.

#### **FORWARD-LOOKING STATEMENTS**

All statements, other than statements of current or historical fact, contained in this filing are forward-looking statements. We have attempted to identify these statements by terminology including "believe," "anticipate," "plan," "expect," "estimate," "intend," "seek," "target," "goal," "may," "will," "should," "can," "continue" and other similar words or expressions in connection with, among other things, any discussion of future operating or financial performance. In particular, these statements include statements about our market opportunity, our growth strategy, competition, expected activities and future acquisitions, investments and the adequacy of our available cash resources. These statements may be found in the various sections of this filing, including those entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," Part I, Item 1A. "Risk Factors," and Part I, Item 3 "Legal Proceedings." Readers are cautioned that matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, regulatory, competitive and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions.

All forward-looking statements included in this filing are based on information available to us on the date of this filing. Actual results may differ from projections or estimates due to a variety of important factors, including:

- our ability to accurately predict and effectively manage health benefits and other operating expenses;
- competition;
- changes in healthcare practices;

- changes in federal or state laws or regulations;
- inflation;
- provider contract changes;
- new technologies;
- reduction in provider payments by governmental payors;
- major epidemics;
- disasters and numerous other factors affecting the delivery and cost of healthcare;
- the expiration, cancellation or suspension of our Medicaid managed care contracts by state governments;
- availability of debt and equity financing, on terms that are favorable to us; and
- general economic and market conditions.

Item 1A "Risk Factors" of Part I of this filing contains a further discussion of these and other additional important factors that could cause actual results to differ from expectations. We disclaim any current intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Due to these important factors and risks, we cannot give assurances with respect to our future premium levels or our ability to control our future medical costs.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

**INVESTMENTS**

As of December 31, 2007, we had short-term investments of \$46.3 million and long-term investments of \$344.3 million, including restricted deposits of \$27.3 million. The short-term investments consist of highly liquid securities with maturities between three and 12 months. The long-term investments consist of municipal, corporate and U.S. Agency bonds, life insurance contracts, U.S. Treasury investments and equity securities and have maturities greater than one year. Restricted deposits consist of investments required by various state statutes to be deposited or pledged to state agencies. Due to the nature of the states' requirements, these investments are classified as long-term regardless of the contractual maturity date. Our investments are subject to interest rate risk and will decrease in value if market rates increase. Assuming a hypothetical and immediate 1% increase in market interest rates at December 31, 2007, the fair value of our fixed income investments would decrease by approximately \$5.3 million. Declines in interest rates over time will reduce our investment income.

**INFLATION**

Although the general rate of inflation has remained relatively stable and healthcare cost inflation has stabilized in recent years, the national healthcare cost inflation rate still exceeds the general inflation rate. We use various strategies to mitigate the negative effects of healthcare cost inflation. Specifically, our health plans try to control medical and hospital costs through our margin protection program and contracts with independent providers of healthcare services. Through these contracted care providers, our health plans emphasize preventive healthcare and appropriate use of specialty and hospital services.

While we currently believe our strategies to mitigate healthcare cost inflation will continue to be successful, competitive pressures, new healthcare and pharmaceutical product introductions, demands from healthcare providers and customers, applicable regulations or other factors may affect our ability to control the impact of healthcare cost increases.

**Item 8. Financial Statements and Supplementary Data**

Our consolidated financial statements and related notes required by this item are set forth on the pages indicated in Item 15.

**QUARTERLY SELECTED FINANCIAL INFORMATION**

(In thousands, except share data and membership data)  
(Unaudited)

	For the Quarter Ended			
	March 31, 2007	June 30, 2007(1)	September 30, 2007	December 31, 2007(2)
Total revenues	\$ 664,234	\$ 727,731	\$ 749,888	\$ 777,439
Net earnings from continuing operations	11,597	10,175	16,464	3,033
Discontinued operations, net of tax	26,614	7,607	(528)	(1,560)
Net earnings	<u>\$ 38,211</u>	<u>\$ 17,782</u>	<u>\$ 15,936</u>	<u>\$ 1,473</u>
Per share data:				
Basic:				
Continued operations	\$ 0.27	\$ 0.23	\$ 0.38	\$ 0.07
Discontinued operations	0.61	0.18	(0.01)	(0.04)
Basic earnings per common share	<u>\$ 0.88</u>	<u>\$ 0.41</u>	<u>\$ 0.37</u>	<u>\$ 0.03</u>
Diluted:				
Continued operations	\$ 0.26	\$ 0.23	\$ 0.37	\$ 0.07
Discontinued operations	0.59	0.17	(0.01)	(0.04)
Diluted earnings per common share	<u>\$ 0.85</u>	<u>\$ 0.40</u>	<u>\$ 0.36</u>	<u>\$ 0.03</u>
Period end membership	1,103,300	1,131,500	1,137,300	1,146,600

(1) Includes a \$3.0 million pre-tax, cash contribution of a portion of the FirstGuard sale proceeds to the company's charitable foundation.

(2) Includes \$4.2 million pre-tax premium revenue refund to the State of Indiana and a \$9.4 million pre-tax charge for impairment and restructuring.

	For the Quarter Ended			
	March 31, 2006(1)	June 30, 2006(2)	September 30, 2006	December 31, 2006
Total revenues	\$378,790	\$417,977	\$ 547,432	\$ 617,795
Net earnings from continuing operations	6,554	439	4,696	9,251
Discontinued operations, net of tax	2,212	4,526	(75,889)	4,582
Net earnings (loss)	<u>\$ 8,766</u>	<u>\$ 4,965</u>	<u>\$ (71,193)</u>	<u>\$ 13,833</u>
Per share data:				
Basic:				
Continued operations	\$ 0.15	\$ 0.01	\$ 0.11	\$ 0.21
Discontinued operations	0.05	0.11	(1.76)	0.11
Basic earnings (loss) per common share	<u>\$ 0.20</u>	<u>\$ 0.12</u>	<u>\$ (1.65)</u>	<u>\$ 0.32</u>
Diluted:				
Continued operations	\$ 0.15	\$ 0.01	\$ 0.10	\$ 0.21
Discontinued operations	0.05	0.10	(1.72)	0.10
Diluted earnings (loss) per common share	<u>\$ 0.20</u>	<u>\$ 0.11</u>	<u>\$ (1.62)</u>	<u>\$ 0.31</u>
Period end membership	722,100	951,500	1,025,100	1,123,300

(1) Includes \$4.7 million pre-tax implementation expenses related to Georgia.

(2) Includes \$8.1 million pre-tax adverse medical cost development in estimated medical claims liabilities from continuing operations from the first quarter of 2006.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures** - Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2007. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of December 31, 2007, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

**Management's Report on Internal Control Over Financial Reporting** - Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control — Integrated Framework*, our management concluded that our internal control over financial reporting was effective at the reasonable assurance level as of December 31, 2007. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2007 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

**Changes in Internal Control Over Financial Reporting** - No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended December 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Centene Corporation:

We have audited Centene Corporation's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Centene Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Centene Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Centene Corporation as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated February 25, 2008 expressed an unqualified opinion on those consolidated financial statements.

(signed) KPMG LLP

St. Louis, Missouri  
February 25, 2008

**Item 9B. *Other Information***

None.

**PART III**

**Item 10. *Directors, Executive Officers of the Registrant and Corporate Governance***

**(a) Directors of the Registrant**

Information concerning our directors will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Election of Directors." This portion of the Proxy Statement is incorporated herein by reference.

**(b) Executive Officers of the Registrant**

Pursuant to General Instruction G(3) to Form 10-K and Instruction 3 to Item 401(b) of Regulation S-K, information regarding our executive officers is provided in Item 1 of Part I of this Annual Report on Form 10-K under the caption "Executive Officers."

**(c) Corporate Governance**

Information concerning certain corporate governance matters will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Information About Corporate Governance — Director Candidates", "Information About Corporate Governance — Board and Committee Meetings" and "Information About Corporate Governance — Audit Committee." These portions of our Proxy Statement are incorporated herein by reference.

**Item 11. *Executive Compensation***

Information concerning executive compensation will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Information About Executive Compensation." This portion of the Proxy Statement is incorporated herein by reference. The sections entitled "Compensation Committee Report" in our 2008 Proxy Statement are not incorporated herein by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information concerning the security ownership of certain beneficial owners and management and our equity compensation plans will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Information About Stock Ownership" and "Equity Compensation Plan Information." These portions of the Proxy Statement are incorporated herein by reference.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

Information concerning certain relationships and related transactions will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Related Party Transactions." This portion of our Proxy Statement is incorporated herein by reference.

**Item 14. *Principal Accountant Fees and Services***

Information concerning principal accountant fees and services will appear in our Proxy Statement for our 2008 annual meeting of stockholders under "Independent Auditor Fees." This portion of our Proxy Statement is incorporated herein by reference.

## **PART IV**

### **Item 15. Exhibits and Financial Statement Schedules**

(a) The following documents are filed as part of this report:

	<u>Page</u>
<b>1. Consolidated Financial Statements</b>	
Report of Independent Registered Public Accounting Firm	54
Consolidated Balance Sheets as of December 31, 2007 and 2006	55
Consolidated Statements of Operations for the Years Ended December 31, 2007, 2006 and 2005	56
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2007, 2006 and 2005	57
Consolidated Statements of Cash Flows for the Years Ended December 31, 2007, 2006 and 2005	58
Notes to Consolidated Financial Statements	59
<b>2. Financial Statement Schedules</b>	
Schedule I — Condensed Financial Information of Registrant	81
<b>3. Exhibits</b>	
The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this filing.	

## **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Centene Corporation:

We have audited the accompanying consolidated balance sheets of Centene Corporation and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule on pages 81-83. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Centene Corporation and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, during 2006, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), "Share Based Payments."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Centene Corporation's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2008 expressed an unqualified opinion on the effectiveness of the operation of internal control over financial reporting.

(signed) KPMG LLP

St. Louis, Missouri  
February 25, 2008

**CENTENE CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

	December 31,	
	2007	2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents of continuing operations	\$ 268,584	\$ 253,370
Cash and cash equivalents of discontinued operations	—	17,677
Total cash and cash equivalents	268,584	271,047
Premium and related receivables	90,072	74,379
Short-term investments, at fair value (amortized cost \$46,392 and \$57,031, respectively)	46,269	56,790
Other current assets	41,414	17,279
Current assets of discontinued operations other than cash	—	32,327
Total current assets	446,339	451,822
Long-term investments, at fair value (amortized cost \$314,681 and \$117,620, respectively)	317,041	116,052
Restricted deposits, at fair value (amortized cost \$27,056 and \$24,512, respectively)	27,301	24,355
Property, software and equipment, net	138,139	110,688
Goodwill	141,030	129,881
Other intangible assets, net	13,205	15,555
Other assets	36,067	9,209
Long-term assets of discontinued operations	—	37,418
Total assets	<u>\$1,119,122</u>	<u>\$ 894,980</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Medical claims liabilities	\$ 335,856	\$ 249,864
Accounts payable and accrued expenses	105,096	63,893
Unearned revenue	44,016	33,816
Current portion of long-term debt and notes payable	971	971
Current liabilities of discontinued operations	861	39,407
Total current liabilities	486,800	387,951
Long-term debt	206,406	174,646
Other liabilities	10,869	5,853
Long-term liabilities of discontinued operations	—	107
Total liabilities	704,075	568,557
Stockholders' equity:		
Common stock, \$.001 par value; authorized 100,000,000 shares; issued and outstanding 43,667,837 and 43,369,918 shares, respectively	44	44
Additional paid-in capital	221,693	209,340
Accumulated other comprehensive income:		
Unrealized gain (loss) on investments, net of tax	1,571	(1,251)
Retained earnings	191,739	118,290
Total stockholders' equity	415,047	326,423
Total liabilities and stockholders' equity	<u>\$1,119,122</u>	<u>\$ 894,980</u>

See notes to consolidated financial statements.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except share data)

	Year Ended December 31,		
	2007	2006	2005
<b>Revenues:</b>			
Premium	\$ 2,759,018	\$ 1,844,452	\$ 1,211,023
Premium tax	79,572	37,961	7,214
Service	80,702	79,581	13,965
Total revenues	<u>2,919,292</u>	<u>1,961,994</u>	<u>1,232,202</u>
<b>Expenses:</b>			
Medical costs	2,324,486	1,555,658	994,517
Cost of services	61,454	60,506	5,851
General and administrative expenses	399,687	280,067	172,349
Premium tax	79,572	37,961	7,214
Total operating expenses	<u>2,865,199</u>	<u>1,934,192</u>	<u>1,179,931</u>
Earnings from operations	54,093	27,802	52,271
<b>Other income (expense):</b>			
Investment and other income	25,169	16,416	9,106
Interest expense	(15,626)	(10,636)	(3,990)
Earnings before income taxes	63,636	33,582	57,387
<b>Income tax expense</b>	<u>22,367</u>	<u>12,642</u>	<u>19,686</u>
Net earnings from continuing operations	41,269	20,940	37,701
Discontinued operations, net of income tax (benefit) expense of \$(30,899), \$9,335 and \$10,538	<u>32,133</u>	<u>(64,569)</u>	<u>17,931</u>
<b>Net earnings (loss)</b>	<u>\$ 73,402</u>	<u>\$ (43,629)</u>	<u>\$ 55,632</u>
<b>Net earnings (loss) per share:</b>			
Basic:			
Continuing operations	\$ 0.95	\$ 0.49	\$ 0.89
Discontinued operations	0.74	(1.50)	0.42
Basic earnings (loss) per common share	<u>\$ 1.69</u>	<u>\$ (1.01)</u>	<u>\$ 1.31</u>
Diluted:			
Continuing operations	\$ 0.92	\$ 0.47	\$ 0.84
Discontinued operations	0.72	(1.45)	0.40
Diluted earnings (loss) per common share	<u>\$ 1.64</u>	<u>\$ (0.98)</u>	<u>\$ 1.24</u>
<b>Weighted average number of shares outstanding:</b>			
Basic	43,539,950	43,160,860	42,312,522
Diluted	44,823,082	44,613,622	45,027,633

See notes to consolidated financial statements.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(In thousands, except share data)

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Unrealized Gain (Loss) on Investments</u>	<u>Retained Earnings</u>	<u>Total</u>
	<u>\$ .001 Par Value Shares</u>	<u>Amt</u>				
<b>Balance, December 31, 2004</b>	41,316,122	\$41	\$165,391	\$ (407)	\$106,287	\$271,312
Net earnings	—	—	—	—	55,632	55,632
Change in unrealized investment losses, net of \$(801) tax	—	—	—	(1,347)	—	(1,347)
Comprehensive earnings						54,285
Common stock issued for acquisitions	318,735	1	8,990	—	—	8,991
Common stock issued for stock options and employee stock purchase plan	1,353,373	1	6,016	—	—	6,017
Stock compensation expense	—	—	4,974	—	—	4,974
Excess tax benefits from stock compensation	—	—	6,469	—	—	6,469
<b>Balance, December 31, 2005</b>	42,988,230	\$43	\$191,840	\$(1,754)	\$161,919	\$352,048
Net loss	—	—	—	—	(43,629)	(43,629)
Change in unrealized investment losses, net of \$306 tax	—	—	—	503	—	503
Comprehensive loss						(43,126)
Common stock issued for stock options and employee stock purchase plan	783,823	1	7,497	—	—	7,498
Common stock repurchases	(402,135)	—	(7,944)	—	—	(7,944)
Stock compensation expense	—	—	14,904	—	—	14,904
Excess tax benefits from stock compensation	—	—	3,043	—	—	3,043
<b>Balance, December 31, 2006</b>	43,369,918	\$44	\$209,340	\$(1,251)	\$118,290	\$326,423
Net earnings	—	—	—	—	73,402	73,402
Change in unrealized investment losses, net of \$1,625 tax	—	—	—	2,822	—	2,822
Comprehensive earnings						76,224
Common stock issued for stock options and employee stock purchase plan	765,076	—	6,113	—	—	6,113
Common stock repurchases	(467,157)	—	(9,541)	—	—	(9,541)
Stock compensation expense	—	—	15,781	—	—	15,781
Adjustment for adoption of FIN 48	—	—	—	—	47	47
<b>Balance, December 31, 2007</b>	<u>43,667,837</u>	<u>\$44</u>	<u>\$221,693</u>	<u>\$ 1,571</u>	<u>\$191,739</u>	<u>\$415,047</u>

See notes to consolidated financial statements.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	Year Ended December 31,		
	2007	2006	2005
<b>Cash flows from operating activities:</b>			
Net earnings (loss)	\$ 73,402	\$ (43,629)	\$ 55,632
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities —			
Depreciation and amortization	27,807	20,600	13,069
Excess tax benefits from stock compensation	—	—	6,469
Stock compensation expense	15,781	14,904	4,974
Gain on sale of FirstGuard Missouri	(7,472)	—	—
Impairment loss	7,207	88,268	—
Deferred income taxes	(10,223)	(6,692)	1,786
Changes in assets and liabilities —			
Premium and related receivables	1,663	(39,765)	(10,305)
Other current assets	(6,253)	5,352	(6,177)
Other assets	(348)	91	(525)
Medical claims liabilities	56,287	108,003	4,534
Unearned revenue	10,085	20,035	8,182
Accounts payable and accrued expenses	31,234	28,136	(4,215)
Other operating activities	3,070	(271)	624
Net cash provided by operating activities	<u>202,240</u>	<u>195,032</u>	<u>74,048</u>
<b>Cash flows from investing activities:</b>			
Purchase of property, software and equipment	(53,937)	(50,318)	(26,909)
Purchase of investments	(606,366)	(319,322)	(150,444)
Sales and maturities of investments	456,738	286,155	176,387
Proceeds from asset sales	14,102	—	—
Investments in acquisitions and equity method investee, net of cash acquired	(36,001)	(66,772)	(55,485)
Net cash used in investing activities	<u>(225,464)</u>	<u>(150,257)</u>	<u>(56,451)</u>
<b>Cash flows from financing activities:</b>			
Proceeds from exercise of stock options	5,464	6,953	5,621
Proceeds from borrowings	212,000	94,359	45,000
Payment of long-term debt and notes payable	(181,981)	(17,355)	(4,552)
Excess tax benefits from stock compensation	—	3,043	—
Common stock repurchases	(9,541)	(7,833)	—
Debt issue costs	(5,181)	(253)	(413)
Net cash provided by financing activities	<u>20,761</u>	<u>78,914</u>	<u>45,656</u>
Net (decrease) increase in cash and cash equivalents	<u>(2,463)</u>	<u>123,689</u>	<u>63,253</u>
Cash and cash equivalents, beginning of period	<u>271,047</u>	<u>147,358</u>	<u>84,105</u>
Cash and cash equivalents, end of period	<u>\$ 268,584</u>	<u>\$ 271,047</u>	<u>\$ 147,358</u>
Interest paid	\$ 11,945	\$ 10,680	\$ 3,291
Income taxes paid	\$ 7,348	\$ 16,418	\$ 31,287
<b>Supplemental schedule of non-cash investing and financing activities:</b>			
Common stock issued for acquisitions	\$ —	\$ —	\$ 8,991
Property acquired under capital leases	\$ 1,736	\$ 366	\$ 5,026

See notes to consolidated financial statements.



**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in thousands, except share data)**

**1. Organization and Operations**

Centene Corporation, or Centene or the Company, is a multi-line healthcare enterprise operating primarily in two segments: Medicaid Managed Care and Specialty Services. Centene's Medicaid Managed Care segment provides Medicaid and Medicaid-related health plan coverage to individuals through government subsidized programs, including Medicaid, the State Children's Health Insurance Program, or SCHIP, and Supplemental Security Income including Aged, Blind or Disabled programs, or SSI. The Company's Specialty Services segment provides specialty services, including behavioral health, life and health management, long-term care programs, managed vision, nurse triage, pharmacy benefits management and treatment compliance, to state programs, healthcare organizations, employer groups, and other commercial organizations, as well as to the Company's own subsidiaries on market-based terms.

**2. Summary of Significant Accounting Policies**

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Centene Corporation and all majority owned subsidiaries. All material intercompany balances and transactions have been eliminated. As discussed below in Note 3, the assets, liabilities and results of operations of FirstGuard Kansas and FirstGuard Missouri are classified as discontinued operations for all periods presented.

*Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

Investments with original maturities of three months or less are considered to be cash equivalents. Cash equivalents consist of commercial paper, money market funds, repurchase agreements and bank savings accounts.

*Investments*

Short-term investments include securities with maturities between three months and one year. Long-term investments include securities with maturities greater than one year.

Short-term and long-term investments are classified as available for sale and are carried at fair value based on quoted market prices. Unrealized gains and losses on investments available for sale are excluded from earnings and reported as a separate component of stockholders' equity, net of income tax effects. Premiums and discounts are amortized or accreted over the life of the related security using the effective interest method. The Company monitors the difference between the cost and fair value of investments. Investments that experience a decline in value that is judged to be other than temporary are written down to fair value and a realized loss is recorded in investment and other income. To calculate realized gains and losses on the sale of investments, the Company uses the specific amortized cost of each investment sold. Realized gains and losses are recorded in investment and other income.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

***Restricted Deposits***

Restricted deposits consist of investments required by various state statutes to be deposited or pledged to state agencies. These investments are classified as long-term, regardless of the contractual maturity date, due to the nature of the states' requirements. The Company is required to annually adjust the amount of the deposit pledged to certain states.

***Property, Software and Equipment***

Property, software and equipment are stated at cost less accumulated depreciation. Capitalized software includes certain costs incurred in the development of internal-use software, including external direct costs of materials and services and payroll costs of employees devoted to specific software development. Depreciation is calculated principally by the straight-line method over estimated useful lives ranging from 40 years for buildings, two to seven years for software and computer equipment and five to seven years for furniture and equipment. Leasehold improvements are depreciated using the straight-line method over the shorter of the expected useful life or the remaining term of the lease ranging between one and ten years.

***Intangible Assets***

Intangible assets represent assets acquired in purchase transactions and consist primarily of customer relationships, purchased contract rights, provider contracts, trade names and goodwill. Purchased contract rights are amortized using the straight-line method over periods ranging from five to ten years. Provider contracts are amortized using the straight-line method over periods ranging from five to ten years. Customer relationships are amortized using the straight-line method over periods ranging from five to fifteen years. Trade names are amortized using the straight line method over 20 years.

Goodwill is reviewed annually during the fourth quarter for impairment. In addition, the Company performs an impairment analysis of other intangible assets based on the occurrence of other factors. Such factors include, but are not limited to, significant changes in membership, state funding, medical contracts and provider networks and contracts. An impairment loss is recognized if the carrying value of intangible assets exceeds the implied fair value.

***Medical Claims Liabilities***

Medical services costs include claims paid, claims reported but not yet paid, or inventory, estimates for claims incurred but not yet received, or IBNR, and estimates for the costs necessary to process unpaid claims.

The estimates of medical claims liabilities are developed using standard actuarial methods based upon historical data for payment patterns, cost trends, product mix, seasonality, utilization of healthcare services and other relevant factors including product changes. These estimates are continually reviewed and adjustments, if necessary, are reflected in the period known. Management did not change actuarial methods during the years presented. Management believes the amount of medical claims payable is reasonable and adequate to cover the Company's liability for unpaid claims as of December 31, 2007; however, actual claim payments may differ from established estimates.

***Revenue Recognition***

The Company's Medicaid Managed Care segment generates revenues primarily from premiums received from the states in which it operates health plans. The company receives a fixed premium per member per month pursuant to our state contracts. The company generally receives premium payments during the month it provides services and recognizes premium revenue during the period in which it is obligated to provide services to its members. Some states enact premium taxes or similar assessments, collectively premium taxes, and these taxes are recorded as a component of both revenues and operating expenses. Premium taxes of

# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

\$79,572, \$37,961, and \$7,214 for the years ended December 31, 2007, 2006 and 2005, respectively, are reported as a separate component of revenues and operating expenses. Some contracts allow for additional premium related to certain supplemental services provided such as maternity deliveries. Revenues are recorded based on membership and eligibility data provided by the states, which may be adjusted by the states for updates to this data. These adjustments have been immaterial in relation to total revenue recorded and are reflected in the period known.

The Company's Specialty Services segment generates revenues under contracts with state programs, healthcare organizations and other commercial organizations, as well as from our own subsidiaries on market-based terms. Revenues are recognized when the related services are provided or as ratably earned over the covered period of service.

Premium and services revenues collected in advance are recorded as unearned revenue. For performance-based contracts the company does not recognize revenue subject to refund until data is sufficient to measure performance. Premiums and service revenues due to the Company are recorded as premium and related receivables and are recorded net of an allowance based on historical trends and management's judgment on the collectibility of these accounts. As the Company generally receives payments during the month in which services are provided, the allowance is typically not significant in comparison to total revenues and does not have a material impact on the presentation of the financial condition or results of operations. Activity in the allowance for uncollectible accounts for the years ended December 31 is summarized below:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Allowances, beginning of year	\$ 155	\$ 343	\$ 462
Amounts charged to expense	226	512	80
Write-offs of uncollectible receivables	<u>(123)</u>	<u>(700)</u>	<u>(199)</u>
Allowances, end of year	<u>\$ 258</u>	<u>\$ 155</u>	<u>\$ 343</u>

### *Significant Customers*

Centene receives the majority of its revenues under contracts or subcontracts with state Medicaid managed care programs. The contracts, which expire on various dates between March 31, 2008 and December 31, 2011, are expected to be renewed. Contracts with the states of Georgia, Indiana, Ohio, Texas and Wisconsin accounted for 23%, 11%, 16%, 25% and 11%, respectively, of the Company's revenues for the year ended December 31, 2007.

### *Reinsurance*

Centene's Medicaid Managed Care subsidiaries have purchased reinsurance from third parties to cover eligible healthcare services. The current reinsurance program covers 50% of inpatient healthcare expenses between of \$500 and \$1,000 and covers 90% of inpatient healthcare expenses in excess of \$1,000 per member, up to a lifetime maximum of \$2,000. Centene's Medicaid Managed Care subsidiaries are responsible for inpatient charges in excess of an average daily per diem.

Reinsurance recoveries were \$1,596, \$2,427, and \$2,931, in 2007, 2006, and 2005, respectively. Reinsurance expenses were approximately \$3,762, \$3,576, and \$3,364, in 2007, 2006, and 2005, respectively. Reinsurance recoveries, net of expenses, are included in medical costs.

### *Other Income (Expense)*

Other income (expense) consists principally of investment income, interest expense and equity method earnings from investments. Investment income is derived from the Company's cash, cash equivalents, restricted

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

deposits and investments. Interest expense relates to borrowings under our credit facilities, mortgage interest, interest on capital leases and credit facility fees.

***Income Taxes***

Deferred tax assets and liabilities are recorded for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of the tax rate change.

Valuation allowances are provided when it is considered more likely than not that deferred tax assets will not be realized. In determining if a deductible temporary difference or net operating loss can be realized, the Company considers future reversals of existing taxable temporary differences, future taxable income, taxable income in prior carryback periods and tax planning strategies.

***Stock Based Compensation***

The Company adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment," or SFAS 123R, effective January 1, 2006, using the modified-prospective transition method. Under this method, compensation cost is recognized for awards granted and for awards modified, repurchased or cancelled in the period after adoption. Compensation cost is also recognized for the unvested portion of awards granted prior to adoption. Prior year financial statements are not restated. The fair value of the Company's employee share options and similar instruments are estimated using the Black-Scholes option-pricing model. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. Additionally, upon adoption of SFAS 123R, excess tax benefits related to stock compensation are presented as a cash inflow from financing activities.

For the year ended December 31, 2005, the Company accounted for stock-based compensation plans under APB Opinion No. 25, "Accounting for Stock Issued to Employees." Compensation cost related to stock options issued to employees was recorded only if the grant-date market price of the underlying stock exceeded the exercise price. The following table illustrates the effect on net earnings and earnings per share if a fair value-based method had been applied to all awards.

	<u>2005</u>
Net earnings	\$ 55,632
Stock-based employee compensation expense included in net earnings, net of related tax effects	3,084
Stock-based employee compensation expense determined under fair value based method, net of related tax effects	<u>(11,988)</u>
Pro forma net earnings	<u>\$ 46,728</u>
<b>Basic earnings per common share:</b>	
As reported	\$ 1.31
Pro forma	1.10
<b>Diluted earnings per common share:</b>	
As reported	\$ 1.24
Pro forma	1.05

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

In October 2005, the Compensation Committee approved the immediate and full acceleration of vesting of 260,000 "out-of-the-money" stock options to certain employees. These employees did not include any of the Company's executive officers or other employees at the Vice President level or above. Each stock option issued as a part of these grants has an exercise price greater than the closing price per share on the date of the Compensation Committee's action. The purpose of the acceleration was to enable the Company to avoid recognizing compensation expense associated with these options in future periods in our consolidated statements of operations, in contemplation of the implementation of SFAS 123R. The pre-tax charge avoided totals approximately \$3,000 which would have been recognized over the years 2006, 2007, 2008 and 2009. This amount is reflected in the pro forma disclosures included above. The options that have been accelerated had an exercise price in excess of the market value of our common stock at the time of acceleration. Accordingly, the Compensation Committee determined that the expense savings outweighs the objective of incentive compensation and retention.

Additional information regarding the stock option plans is included in Note 14.

***Reclassifications***

Certain amounts in the consolidated financial statements have been reclassified to conform to the 2007 presentation. These reclassifications have no effect on net earnings or stockholders' equity as previously reported.

***Recent Accounting Pronouncements***

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations", or SFAS No. 141R. The purpose of issuing the statement is to replace current guidance in SFAS No. 141 to better represent the economic value of a business combination transaction. The changes to be effected with SFAS No. 141R from the current guidance include, but are not limited to: (1) acquisition costs will be recognized separately from the acquisition; (2) known contractual contingencies at the time of the acquisition will be considered part of the liabilities acquired measured at their fair value; all other contingencies will be part of the liabilities acquired measured at their fair value only if it is more likely than not that they meet the definition of a liability; (3) contingent consideration based on the outcome of future events will be recognized and measured at the time of the acquisition; (4) business combinations achieved in stages (step acquisitions) will need to recognize the identifiable assets and liabilities, as well as noncontrolling interests, in the acquiree, at the full amounts of their fair values; and (5) a bargain purchase (defined as a business combination in which the total acquisition-date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any noncontrolling interest in the acquiree) will require that excess to be recognized as a gain attributable to the acquirer. SFAS No. 141R will be effective for any business combinations that occur after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of ARB No. 51", or SFAS No. 160. SFAS No. 160 was issued to improve the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report noncontrolling (minority) interests in subsidiaries in the same way, that is, as equity in the consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. SFAS No. 160 will be effective January 1, 2009. The Company is currently evaluating the impact that SFAS No. 160 will have on its financial statements and disclosures.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", or FIN 48, on January 1, 2007. FIN 48 clarifies whether or not to recognize assets or liabilities for tax positions taken that may be challenged by a taxing authority. Additional information regarding FIN 48 is included in Note 9.

# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

### 3. Discontinued Operations: FirstGuard Health Plans

In 2006, FirstGuard Health Plan Kansas, Inc., or FirstGuard Kansas, a wholly owned subsidiary, received notification that its Medicaid contract scheduled to terminate December 31, 2006 would not be renewed. In 2006, the Company also evaluated its strategic alternatives for its Missouri subsidiary, FirstGuard Health Plan, Inc., or FirstGuard Missouri, and decided to divest the business. The assets, liabilities and results of operations of FirstGuard Kansas and FirstGuard Missouri are classified as discontinued operations for all periods presented beginning in December 2007, as substantially all liabilities have been paid as of that date.

In 2006, as a result of the notification of the Kansas contract non-renewal, the Company conducted an impairment analysis of the identifiable intangible assets and goodwill of the FirstGuard reporting unit, which encompasses both the FirstGuard Kansas and FirstGuard Missouri health plans. The fair value of the FirstGuard reporting unit was determined using discounted expected cash flows and estimated market value. The impairment analysis resulted in a goodwill impairment of \$81,098. The Company also recorded impairment charges for identifiable intangible assets of \$5,993, and fixed assets of \$1,177. The goodwill portion of the impairment was not deductible for tax purposes.

The sale of the operating assets of FirstGuard Missouri was completed effective February 1, 2007 and the Company received a final contingent payment in the second quarter of 2007, resulting in a total gain on the sale of \$7,472 in 2007. Goodwill associated with FirstGuard written off as part of the transaction was \$5,995.

In 2007, the Company abandoned the stock of FirstGuard Kansas and FirstGuard Missouri to an unrelated entity. As a result of that abandonment, the Company recognized expense of \$2,298 for the write-off of the remaining assets in that entity. The Company also recognized a \$34,856 tax benefit for the tax deduction associated with the basis of that stock.

The Company incurred \$8,733 of FirstGuard exit costs consisting primarily of lease termination fees and employee severance costs. The exit costs included \$6,202 incurred in 2006, of which \$3,027 was accrued at December 31, 2006. During the year ended December 31, 2007, the Company incurred an additional \$2,531 of exit costs and made payments of \$5,433. At December 31, 2007, the remaining accrual for these costs was \$125. The Company also contributed \$3,000 of the sale proceeds received in the second quarter to its charitable foundation and recorded the contribution as General and Administrative expense.

Operating results for the discontinued operations are as follows:

	Year Ended December 31,		
	2007	2006	2005
Revenues	\$ 6,688	\$ 317,026	\$ 273,662
Earnings (loss) before income taxes	\$ 1,234	\$ (55,234)	\$ 28,469
Net earnings (loss)	\$ 32,133	\$ (64,569)	\$ 17,931

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Assets and liabilities of the discontinued operations are as follows:

	December 31,	
	2007	2006
Current assets	\$ —	\$ 50,004
Long term investments and restricted deposits	—	30,275
Goodwill	—	5,995
Other intangible assets, net	—	647
Other assets	—	501
Assets of discontinued operations	<u>\$ —</u>	<u>\$ 87,422</u>

	December 31,	
	2007	2006
Medical claims liabilities	\$ 736	\$ 30,577
Accounts payable and accrued expenses	125	8,830
Other liabilities	—	107
Liabilities of discounted operations	<u>\$ 861</u>	<u>\$ 39,514</u>

#### 4. Restructuring

In the fourth quarter of 2007, the Company abandoned its previously planned redevelopment project in Clayton, Missouri, related to a corporate office expansion. As a result, the Company conducted an impairment analysis of the related real estate and capitalized construction costs and recorded an impairment charge of \$7,207. The impairment charges were recorded as General and Administrative expense under the Medicaid Managed Care segment. At December 31, 2007, the remaining liability for these charges was \$1,335.

Also in the fourth quarter of 2007, the Company completed an organizational realignment, resulting in the elimination of approximately 35 positions. Accordingly, the Company recorded \$2,185 in severance costs. This expense was recorded as General and Administrative expense under the Medicaid Managed Care segment. At December 31, 2007, the remaining liability for these costs was \$2,185.

#### 5. Acquisitions

##### *2007 Acquisitions*

- *Access Health Solution, LLC.* In July 2007, the Company acquired a 49% minority ownership interest in Access Health Solutions, LLC, or Access, a Medicaid managed care entity in Florida. Under the terms of the transaction, the Company has an option to acquire the remaining interest in Access at a future date. The Company accounts for its investment in Access using the equity method of accounting.
- *Other 2007 Acquisitions.* The Company acquired PhyTrust of South Carolina, LLC, effective April 20, 2007, Physician's Choice, LLC, effective October 2007, and Work Life Innovations, effective November 30, 2007. The Company paid a total of \$11,300 in cash and related transaction costs for these acquisitions. PhyTrust of South Carolina and Physician's Choice, LLC, both with Medicaid members in South Carolina, are included in the Medicaid Managed Care segment. Work Life Innovations, a health and wellness consulting company, is included in the Specialty Services segment. For these acquisitions, goodwill of \$8,323 and \$2,859 was allocated to the Medicaid Managed Care segment and the Specialty

## CENTENE CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Services segment, respectively, all of which is deductible for income tax purposes. Pro forma disclosures related to these acquisitions have been excluded as immaterial.

#### 2006 Acquisitions

- *US Script, Inc.* Effective January 1, 2006, the Company acquired 100% of US Script, Inc., a pharmacy benefits manager. The Company has paid or accrued \$44,573 in cash and related transaction costs. In accordance with the terms of the agreement, the Company may pay up to an additional \$6,000 if US Script, Inc. achieves certain earnings targets over the next three years. The results of operations for US Script, Inc. are included in the Specialty Services segment and the consolidated financial statements since January 1, 2006.

The purchase price allocation resulted in estimated identifiable intangible assets of \$7,100 and associated deferred tax liabilities of \$2,523 and goodwill of \$37,975. The identifiable intangible assets have an estimated useful life of seven to 20 years. The acquired goodwill is not deductible for income tax purposes. Pro forma disclosures related to the acquisition have been excluded as immaterial.

- *Other 2006 Acquisitions.* The Company acquired the assets of Nurse Response, Inc., effective April 1, 2006, Cardium Health Services Corporation, effective May 9, 2006, MediPlan Corporation, effective June 1, 2006, and OptiCare Managed Vision, Inc., effective July 1, 2006. The Company paid a total of \$30,783 in cash and related transaction costs for these acquisitions. The results of operations for these acquisitions are included in the consolidated financial statements since the respective effective dates. Nurse Response, Inc., a provider of after hours nurse triage services, Cardium Health Services Corporation, a chronic health management provider, and OptiCare Managed Vision, Inc., a managed vision provider, are included in the Specialty Services segment. MediPlan Corporation, with Medicaid membership in Ohio, is included in the Medicaid Managed Care segment. For these acquisitions, goodwill of \$14,756 and \$7,150 was allocated to the Specialty Services segment and Medicaid Managed Care segment, respectively, of which \$5,593 is deductible for income tax purposes. Pro forma disclosures related to these acquisitions have been excluded as immaterial.

#### 2005 Acquisitions

- *AirLogix, Inc.* Effective July 22, 2005, the Company acquired 100% of AirLogix, Inc., a health management provider. The Company paid approximately \$36,310 in cash and related transaction costs. The results of operations for AirLogix, Inc. are included in the Specialty Services segment and the consolidated financial statements since July 22, 2005.

The purchase price allocation resulted in estimated identified intangible assets of \$1,900 and associated deferred tax liabilities of \$997 and goodwill of \$28,747. The identifiable intangible assets have an estimated useful life of one to five years. The acquired goodwill is not deductible for income tax purposes. Pro forma disclosures related to the acquisition have been excluded as immaterial.

- *SummaCare, Inc.* Effective May 1, 2005, the Company acquired certain Medicaid-related assets from SummaCare, Inc. for a purchase price of approximately \$30,407. The purchase price and related transaction costs consisted of \$21,416 in cash and 318,735 shares of common stock valued at \$8,991. The cost to acquire the Medicaid-related assets has been allocated to the assets acquired and liabilities assumed according to estimated fair values. The results of operations for SummaCare are included in the Medicaid Managed Care segment and the consolidated financial statements since May 1, 2005.

The purchase price allocation resulted in identified intangible assets of \$520, representing purchased contract rights and provider contracts and goodwill of \$29,887. The identified intangible assets are being amortized over periods ranging from five to ten years. The acquired goodwill is deductible for



# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

income tax purposes. Pro forma disclosures related to the acquisition have been excluded as immaterial.

### 6. Short-term and Long-term Investments and Restricted Deposits

Short-term and long-term investments and restricted deposits available for sale by investment type at December 31, 2007 consist of the following:

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 28,383	\$ 289	\$ (27)	\$ 28,645
Corporate securities	33,692	14	(268)	33,438
State and municipal securities	305,433	2,336	(130)	307,639
Life insurance contracts	13,924	—	—	13,924
Equity securities	6,697	354	(86)	6,965
Total	<u>\$388,129</u>	<u>\$ 2,993</u>	<u>\$ (511)</u>	<u>\$390,611</u>

Short-term and long-term investments and restricted deposits available for sale by investment type at December 31, 2006 consist of the following:

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 28,320	\$ 13	\$ (340)	\$ 27,993
Corporate securities	76,752	1	(937)	75,816
State and municipal securities	80,450	—	(705)	79,745
Asset backed securities	777	2	—	779
Life insurance contracts	12,864	—	—	12,864
Total	<u>\$199,163</u>	<u>\$ 16</u>	<u>\$(1,982)</u>	<u>\$197,197</u>

The Company monitors investments for other than temporary impairment. Certain investments have experienced a decline in market value due to changes in market interest rates. Based on the credit quality of the Company's investments and ability to hold these investments to recovery (which may be maturity), no

# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

other than temporary impairment has been recorded. Investments in a gross unrealized loss position at December 31, 2007 are as follows:

	Amortized Cost	Less Than 12 Months		12 Months or More		Total	
		Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value
Equity	\$ 1,778	\$ (86)	\$ 1,692	\$ —	\$ —	\$ (86)	\$ 1,692
Corporate	28,674	(6)	907	(262)	27,499	(268)	28,406
Government	8,274	(21)	6,154	(6)	2,093	(27)	8,247
Municipal	29,942	(4)	5,517	(126)	24,295	(130)	29,812
Total	<u>\$68,668</u>	<u>\$(117)</u>	<u>\$14,270</u>	<u>\$(394)</u>	<u>\$53,887</u>	<u>\$(511)</u>	<u>\$68,157</u>

Investments in a gross unrealized loss position at December 31, 2006 are as follows:

	Amortized Cost	Less Than 12 Months		12 Months or More		Total	
		Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value
Corporate	\$ 68,195	\$ (10)	\$16,973	\$ (927)	\$50,285	\$ (937)	\$ 67,258
Government	27,039	(65)	15,417	(275)	11,282	(340)	26,699
Municipal	61,297	(46)	23,637	(659)	36,955	(705)	60,592
Total	<u>\$156,531</u>	<u>\$(121)</u>	<u>\$56,027</u>	<u>\$(1,861)</u>	<u>\$98,522</u>	<u>\$(1,982)</u>	<u>\$154,549</u>

The contractual maturities of short-term and long-term investments and restricted deposits as of December 31, 2007, are as follows:

	Investments		Restricted Deposits	
	Amortized Cost	Estimated Market Value	Amortized Cost	Estimated Market Value
One year or less	\$ 46,392	\$ 46,269	\$15,326	\$15,413
One year through five years	204,311	206,296	11,223	11,359
Five years through ten years	29,524	29,899	507	529
Greater than ten years	80,846	80,846	—	—
Total	<u>\$361,073</u>	<u>\$363,310</u>	<u>\$27,056</u>	<u>\$27,301</u>

The contractual maturities of short-term and long-term investments and restricted deposits as of December 31, 2006, are as follows:

	Investments		Restricted Deposits	
	Amortized Cost	Estimated Market Value	Amortized Cost	Estimated Market Value
One year or less	\$ 57,031	\$ 56,790	\$12,631	\$12,544
One year through five years	86,551	85,006	11,375	11,314
Five years through ten years	13,869	13,846	506	497
Greater than ten years	17,200	17,200	—	—
Total	<u>\$174,651</u>	<u>\$172,842</u>	<u>\$24,512</u>	<u>\$24,355</u>

# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Actual maturities may differ from contractual maturities due to call or prepayment options. Asset backed securities are included in the one year through five years category, while equity securities and life insurance contracts are included in the five years through ten years category. The Company has the option to redeem at amortized cost all of the securities included in the greater than ten years category listed above.

The Company recorded realized gains and losses on investments for the years ended December 31 as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Gross realized gains	\$ 325	\$ 9	\$ —
Gross realized losses	<u>(401)</u>	<u>(37)</u>	<u>(65)</u>
Net realized (losses) gains	<u>\$ (76)</u>	<u>\$ (28)</u>	<u>\$ (65)</u>

### 7. Property, Software and Equipment

Property, software and equipment consist of the following as of December 31:

	<u>2007</u>	<u>2006</u>
Computer software	\$ 72,946	\$ 44,292
Building	36,781	34,671
Computer hardware	26,742	19,580
Furniture and office equipment	21,545	16,114
Land	19,509	20,216
Leasehold improvements	<u>15,200</u>	<u>9,226</u>
	192,723	144,099
Less accumulated depreciation	<u>(54,584)</u>	<u>(33,411)</u>
Property, software and equipment, net	<u>\$138,139</u>	<u>\$110,688</u>

Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was \$23,224, \$15,610 and \$7,809, respectively.

### 8. Intangible Assets

Goodwill balances and the changes therein are as follows:

	<u>Medicaid Managed Care</u>	<u>Specialty Services</u>	<u>Total</u>
Balance as of December 31, 2005	\$ 36,792	\$ 33,388	\$ 70,180
Acquisitions	6,893	52,948	59,841
Other adjustments	<u>50</u>	<u>(190)</u>	<u>(140)</u>
Balance as of December 31, 2006	43,735	86,146	129,881
Acquisitions	8,663	4,049	12,712
Other adjustments	<u>1,238</u>	<u>(2,801)</u>	<u>(1,563)</u>
Balance as of December 31, 2007	<u>\$ 53,636</u>	<u>\$ 87,394</u>	<u>\$ 141,030</u>

Goodwill additions in 2007 and 2006 were related to the acquisitions discussed in Note 5. Goodwill reductions in 2006 and 2007 were related to the recognition of acquired net operating loss carry forward benefits.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Other intangible assets at December 31 consist of the following:

	<u>2007</u>	<u>2006</u>	<u>Weighted Average Life in Years</u>	<u>2007</u>	<u>2006</u>
Purchased contract rights	\$ 8,591	\$ 8,591	7.7	7.6	
Provider contracts	2,478	1,921	10.0	9.9	
Customer relationships	7,030	5,400	8.2	6.3	
Trade names	4,563	3,750	19.9	19.7	
Other intangibles	<u>270</u>	<u>3,270</u>	<u>5.0</u>	<u>5.0</u>	
Other intangible assets	22,932	22,932	10.7	9.2	
Less accumulated amortization:					
Purchased contract rights	(5,870)	(4,830)			
Provider contracts	(1,007)	(729)			
Customer relationships	(2,069)	(1,025)			
Trade names	(542)	(280)			
Other identifiable intangibles	<u>(239)</u>	<u>(513)</u>			
Total accumulated amortization	<u>(9,727)</u>	<u>(7,377)</u>			
Other intangible assets, net	<u>\$13,205</u>	<u>\$15,555</u>			

Amortization expense was \$2,350, \$2,484 and \$1,880 for the years ended December 31, 2007, 2006 and 2005, respectively. The estimated amortization expense for 2008, 2009, 2010, 2011 and 2012, assuming no further acquisitions, is approximately \$2,300, \$2,000, \$1,800, \$1,500 and \$1,500, respectively.

**9. Income Taxes**

The consolidated income tax expense consists of the following for the years ended December 31:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current provision:			
Federal	\$ 30,668	\$ 14,898	\$ 17,195
State and local	<u>3,454</u>	<u>1,845</u>	<u>744</u>
Total current provision	34,122	16,743	17,939
Deferred provision	<u>(11,755)</u>	<u>(4,101)</u>	<u>1,747</u>
Total provision for income taxes	<u>\$ 22,367</u>	<u>\$ 12,642</u>	<u>\$ 19,686</u>

The reconciliation of the tax provision at the U.S. Federal Statutory Rate to the provision for income taxes is as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Tax provision at the U.S. federal statutory rate	\$ 22,273	\$ 11,754	\$ 20,085
State income taxes, net of federal income tax benefit	449	137	(938)
Tax exempt investment income	(2,641)	(640)	—
Nondeductible incentive stock option compensation	1,542	1,407	—
Other, net	<u>744</u>	<u>(16)</u>	<u>539</u>
Income tax expense	<u>\$ 22,367</u>	<u>\$ 12,642</u>	<u>\$ 19,686</u>

# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The tax effects of temporary differences which give rise to deferred tax assets and liabilities are presented below for the years ended December 31:

	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Current:		
Medical claims liability and other accruals	\$ 12,681	\$ 7,383
Unearned premium and other deferred revenue	3,376	3,238
Unrealized loss on investments	47	103
Federal net operating loss carry forward	5,396	1,136
State net operating loss carry forward	2,981	1,387
Federal tax credits	188	—
Other	1,802	52
	26,471	13,299
Valuation allowance	(1,288)	(1,337)
Net current deferred tax assets	<u>\$ 25,183</u>	<u>\$ 11,962</u>
Non-current deferred tax assets:		
Medical claims liability and other accruals	\$ 593	\$ 330
Unrealized loss on investments	—	635
Federal net operating loss carry forward	5,652	5,153
State net operating loss carry forward	3,979	1,053
Stock compensation	8,671	5,491
State tax credits	1,290	1,290
Other	1,147	519
	21,332	14,471
Valuation allowance	(1,038)	(1,455)
Net non-current deferred tax assets	<u>\$ 20,294</u>	<u>\$ 13,016</u>
Deferred tax liabilities:		
Current:		
Prepaid assets	\$ 1,505	\$ 1,923
Net current deferred tax liabilities	<u>\$ 1,505</u>	<u>\$ 1,923</u>
Non-current deferred tax liabilities:		
Intangible assets	\$ 5,012	\$ 5,570
Depreciation and amortization	15,895	6,961
Unrealized gain on investments	957	4
Net non-current deferred tax liabilities	<u>\$ 21,864</u>	<u>\$ 12,535</u>
Net deferred tax assets	<u>\$ 22,108</u>	<u>\$ 10,520</u>

The Company's deferred tax assets include federal and state net operating losses, or NOLs, of which \$6,434 were acquired in business combinations. Accordingly, the total and annual deduction for those NOLs is limited by tax law. The federal NOLs expire between the years 2011 and 2027 and the state NOLs expire

## CENTENE CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

between the years 2009 and 2027. Valuation allowances are recorded for those NOLs the Company believes are more-likely-than-not to expire unused. During 2007 and 2006, the Company recorded valuation allowance reductions of \$2,317 and \$2,910, respectively and recorded additional valuation allowances of \$1,852 and \$2,005, respectively. The 2007 tax provision included \$1,852 of valuation additions and the 2006 tax provision included \$422 of the valuation allowance reductions. The remainder was recorded as an adjustment to goodwill and other intangible assets. The Company also had an unrecorded federal and state net operating loss deferred tax asset related to an excess stock compensation deduction of \$2,546.

We adopted the provision of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", or FIN 48, on January 1, 2007. FIN 48 clarifies whether or not to recognize assets or liabilities for tax positions taken that may be challenged by a tax authority. As a result of the implementation of FIN 48, we recognized a \$47 decrease in the liability for unrecognized tax benefits, which was accounted for as an increase to retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance as of January 1, 2007	\$ 3,114
Additions based on tax positions during the current year	106
Reductions as a result of a lapse in the applicable statute of limitations	<u>(737)</u>
Balance as of December 31, 2007	<u>\$ 2,483</u>

The December 31, 2007 balance includes \$532 (net of federal tax benefit) that would decrease income tax expense, if recognized, and the remainder would reduce goodwill. Most of the amount that would reduce income tax expense, if recognized, related to an audit in process and is expected to be resolved in the next twelve months.

We recognize interest accrued related to unrecognized tax benefits in the provision for income taxes. As of January 1, 2007, interest accrued was approximately \$293, net of federal tax benefit. No penalties have been accrued. As of December 31, 2007, interest accrued was approximately \$249, net of federal tax benefit. The Company recognized net reductions in accrued interest due to the lapse of certain federal and state statutes of limitation.

The federal income tax returns for 2004 through 2007 are open tax years. We file in numerous state jurisdictions with varying statutes of limitation. The unrecognized state tax benefits are related to returns open from 2002 through 2007.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**10. Medical Claims Liabilities**

The change in medical claims liabilities is summarized as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Balance, January 1	\$ 249,864	\$ 139,687	\$ 139,602
Acquisitions	—	1,788	—
Incurred related to:			
Current year	2,340,716	1,569,082	1,010,656
Prior years	<u>(16,230)</u>	<u>(13,424)</u>	<u>(16,139)</u>
Total incurred	<u>2,324,486</u>	<u>1,555,658</u>	<u>994,517</u>
Paid related to:			
Current year	2,009,881	1,322,607	872,019
Prior years	<u>228,613</u>	<u>124,662</u>	<u>122,413</u>
Total paid	<u>2,238,494</u>	<u>1,447,269</u>	<u>994,432</u>
Balance, December 31	<u>\$ 335,856</u>	<u>\$ 249,864</u>	<u>\$ 139,687</u>

Changes in estimates of incurred claims for prior years were attributable to favorable development, including changes in medical utilization and cost trends.

The Company had reinsurance recoverables related to medical claims liabilities of \$3,189 and \$1,244 at December 31, 2007 and 2006, respectively, included in premium and related receivables.

**11. Debt**

Debt consists of the following at December 31:

	<u>2007</u>	<u>2006</u>
\$300,000 revolving credit agreement	\$ 5,000	\$ 149,000
\$175,000 senior notes	175,000	—
\$25,000 revolving loan agreement	8,359	8,359
Mortgage notes payable	12,001	12,487
Capital leases	<u>7,017</u>	<u>5,771</u>
Total debt	207,377	175,617
Less current maturities	<u>(971)</u>	<u>(971)</u>
Long-term debt	<u>\$ 206,406</u>	<u>\$ 174,646</u>

In March 2007, the Company issued \$175,000 aggregate principal amount of 7¼% Senior Notes due April 1, 2014, or the Notes. The Notes have been registered under the Securities Act of 1933, as amended, pursuant to a registration rights agreement with the initial purchasers. The indenture governing the Notes contains non-financial and financial covenants, including requirements of a minimum fixed charge coverage ratio. Interest is paid semi-annually in April and October.

The Company has a \$300,000 five-year Revolving Credit Agreement dated September 14, 2004 with various financial institutions. Borrowings under the agreement bear interest based upon LIBOR rates, the Federal Funds Rate or the Prime Rate. There is a commitment fee on the unused portion of the agreement that ranges from 0.15% to 0.275% depending on the total debt-to-EBITDA ratio. The agreement contains non-financial and financial covenants, including requirements of minimum fixed charge coverage ratios, maximum

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

debt-to-EBITDA ratios and minimum tangible net worth. The agreement will expire in September 2011. The outstanding borrowings at December 31, 2007 bore interest at LIBOR plus 1.0%, or 6.0%.

In May 2006, the Company executed a three-year \$25,000 Revolving Loan Agreement. Borrowings under the agreement bear interest based upon LIBOR rates plus 1.5%. Subject to the terms and conditions of the agreement, the proceeds of the Revolving Loan may only be used for the acquisition of certain properties contiguous to the Company's corporate headquarters. The collateralized properties had a net book value of \$8,543 at December 31, 2007. The outstanding borrowings at December 31, 2007 bore interest at 6.5%.

Mortgage notes payable consists of two mortgages collateralized by the Company's headquarters property. The mortgages bear interest at the prevailing prime rate less .75% (6.5% at December 31, 2007). The respective properties had a net book value of \$20,605 at December 31, 2007. The mortgages include a financial covenant requiring a minimum rolling twelve-month debt service coverage ratio.

Aggregate maturities for the Company's debt are as follows:

2008	\$ 971
2009	9,085
2010	11,275
2011	5,249
2012	260
Thereafter	<u>180,537</u>
Total	<u>\$ 207,377</u>

The fair value of outstanding debt was approximately \$206,065 and \$175,617 at December 31, 2007 and 2006, respectively.

## **12. Stockholders' Equity**

The Company has 10,000,000 authorized shares of preferred stock at \$.001 par value. At December 31, 2007, there were no preferred shares outstanding.

In October 2007, the Company's board of directors extended the November 2005 stock repurchase program, authorizing the Company to repurchase up to 4,000,000 shares of common stock from time to time on the open market or through privately negotiated transactions. The repurchase program expires October 31, 2008, but the Company reserves the right to suspend or discontinue the program at any time. During the year ended December 31, 2007, the Company repurchased 467,157 shares at an average price of \$20.42 and an aggregate cost of \$9,541. During the year ended December 31, 2006, the Company repurchased 402,135 shares at an average price of \$19.77 and an aggregate cost of \$7,944.

## **13. Statutory Capital Requirements and Dividend Restrictions**

Various state laws require Centene's regulated subsidiaries to maintain minimum capital levels specified by each state and restrict the amount of dividends that may be paid without prior regulatory approval. At December 31, 2007 and 2006, Centene's subsidiaries had aggregate statutory capital and surplus of \$302,100 and \$205,700, respectively, compared with the required minimum aggregate statutory capital and surplus of \$192,300 and \$120,600, respectively.



# CENTENE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

### 14. Stock Incentive Plans

The Company's stock incentive plans allow for the granting of restricted stock or restricted stock unit awards and options to purchase common stock. Both incentive stock options and nonqualified stock options can be awarded under the plans. No option will be exercisable for longer than ten years after the date of grant. The plans have 589,239 shares available for future awards. Compensation expense for stock options and restricted stock unit awards is recognized on a straight-line basis over the vesting period, generally three to five years for stock options and one to ten years for restricted stock or restricted stock unit awards. Certain restricted stock unit awards contain performance-based as well as service-based provisions. Certain awards provide for accelerated vesting if there is a change in control as defined in the plans. The compensation cost that has been charged against income for the stock incentive plans was \$15,781, \$14,904 and \$4,974 for the years ended December 31, 2007, 2006 and 2005, respectively. The total income tax benefit recognized in the income statement for stock-based compensation arrangements was \$4,536, \$4,235 and \$1,890 for the years ended December 31, 2007, 2006 and 2005, respectively.

Option activity for the year ended December 31, 2007 is summarized below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2006	4,835,963	\$ 17.77		
Granted	582,500	23.29		
Exercised	(652,862)	7.29		
Expired	(140,300)	26.15		
Forfeited	(284,600)	21.08		
Outstanding as of December 31, 2007	<u>4,340,701</u>	<u>\$ 19.60</u>	<u>\$ 34,977</u>	<u>7.0</u>
Exercisable as of December 31, 2007	<u>2,440,470</u>	<u>\$ 17.23</u>	<u>\$ 25,454</u>	<u>6.1</u>

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Year Ended December 31,		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Expected life (in years)	6.1	6.5	6.4
Risk-free interest rate	4.1%	4.6%	4.3%
Expected volatility	47.5%	47.8%	46.6%
Expected dividend yield	0%	0%	0%

For the year ended December 31, 2007, the Company used a projected expected life for each award granted based on historical experience of employees' exercise behavior. For the years ended December 31, 2006 and 2005, the expected life of each award granted was calculated using the "simplified method" in accordance with Staff Accounting Bulletin No. 107. For the years ended December 31, 2007, 2006 and 2005, expected volatility is primarily based on historical volatility levels along with the implied volatility of exchange traded options to purchase Centene common stock. The risk-free interest rates are based on the implied yield currently available on U.S. Treasury zero coupon issues with a remaining term equal to the expected life.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Other information pertaining to option activity during the year ended December 31, 2007, 2006 and 2005 is as follows:

	Year Ended December 31,		
	2007	2006	2005
Weighted-average fair value of options granted	\$ 12.02	\$ 13.42	\$ 13.77
Total intrinsic value of stock options exercised	\$ 9,847	\$ 10,495	\$ 32,425

A summary of the status of the Company's non-vested restricted stock and restricted stock unit shares as of December 31, 2007, and changes during the year ended December 31, 2007, is presented below:

	Shares	Weighted Average Grant Date Fair Value
Non-vested balance as of December 31, 2006	1,296,131	\$ 25.12
Granted	373,705	24.04
Vested	(78,647)	27.11
Forfeited	(18,500)	26.90
Non-vested balance as of December 31, 2007	<u>1,572,689</u>	<u>\$ 24.74</u>

The total fair value of restricted stock and restricted stock units vested during the years ended December 31, 2007, 2006 and 2005, was \$2,168, \$1,051 and \$0, respectively.

As of December 31, 2007, there was \$43,176 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans; that cost is expected to be recognized over a weighted-average period of 2.4 years. The actual tax benefit realized for the tax deductions from stock option exercises totaled \$512, \$3,455, and \$6,468 for the years ended December 31, 2007, 2006 and 2005, respectively.

The Company has reserved 900,000 shares of common stock for an employee stock purchase plan and the Company issued 32,563 shares, 34,357 shares, and 45,497 shares in 2007, 2006 and 2005, respectively, from the employee stock purchase plan.

#### **15. Retirement Plan**

Centene has a defined contribution plan which covers substantially all employees who are at least twenty-one years of age. Under the plan, eligible employees may contribute a percentage of their base salary, subject to certain limitations. Centene may elect to match a portion of the employee's contribution. Company expense related to matching contributions to the plan were \$2,406, \$1,847 and \$1,124 during the years ended December 31, 2007, 2006 and 2005, respectively.

#### **16. Commitments**

Centene and its subsidiaries lease office facilities and various equipment under non-cancelable operating leases which may contain escalation provisions. The rental expense related to these leases is recorded on a straight-line basis over the lease term, including rent holidays. Rent expense was \$15,869, \$11,414 and \$7,115

## CENTENE CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

for the years ended December 31, 2007, 2006 and 2005, respectively. Annual non-cancelable minimum lease payments over the next five years and thereafter are as follows:

2008	\$ 19,046
2009	17,771
2010	14,741
2011	13,309
2012	11,128
Thereafter	<u>56,932</u>
	<u>\$132,927</u>

#### 17. Contingencies

As previously disclosed, two class action lawsuits were filed against the Company and certain of its officers and directors in the United States District Court for the Eastern District of Missouri, or Eastern District Court. The lawsuits were consolidated on November 2, 2006 and an amended consolidated complaint was filed in the Eastern District Court on January 17, 2007, referred to as the Consolidated Lawsuit. The Consolidated Lawsuit alleges, on behalf of purchasers of the Company's common stock from April 25, 2006 through July 17, 2006, that the Company and certain of its officers and directors violated federal securities laws by issuing a series of materially false statements prior to the announcement of its fiscal 2006 second quarter results. According to the Consolidated Lawsuit, these allegedly materially false statements had the effect of artificially inflating the price of the Company's common stock, which subsequently dropped after the issuance of a press release announcing the Company's preliminary fiscal 2006 second quarter earnings and revised guidance. The Company filed a motion to dismiss the Consolidated Lawsuit. On June 29, 2007, the motion to dismiss was granted. The plaintiffs have appealed the order of dismissal, and briefing on the appeal has been completed. Oral argument on the appeal has not yet been held.

Additionally, in August 2006, a separate derivative action was filed on behalf of Centene Corporation against the Company and certain of its officers and directors in the Eastern District Court. Plaintiff purported to bring suit derivatively on behalf of the Company against the Company's directors for breach of fiduciary duties, gross mismanagement and waste of corporate assets by reason of the directors' alleged failure to correct the misstatements alleged in the Consolidated Lawsuit discussed above. The derivative complaint largely repeated the allegations in the Consolidated Lawsuit. Based on discussions that have been held with plaintiff's counsel, it is the Company's understanding that plaintiff did not intend to pursue this action unless the Consolidated Lawsuit proceeded past the dismissal stage. The derivative action has been dismissed.

The Company's subsidiary, Peach State Health Plan, received notice from the Georgia Department of Community Health, or GDCH, regarding the responsibility for payment of certain dual eligibility SSI claims. GDCH claims the Company is responsible for payment of health care claims for members while enrolled in the Georgia Families managed care program, including hospital stays that extend into the period where the member is covered by the State's separate SSI program. The Company is currently in discussions with the State regarding coverage and premium sufficiency for the SSI eligibles. The ultimate amount of prior claims to be paid as well as any adjustment to premiums for these services is uncertain.

In addition, the Company is routinely subjected to legal proceedings in the normal course of business. While the ultimate resolution of such matters is uncertain, the Company does not expect the results of any of these matters discussed above individually, or in the aggregate, to have a material effect on its financial position or results of operations.

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**18. Earnings Per Share**

The following table sets forth the calculation of basic and diluted net earnings per share for the years ended December 31:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Earnings:			
Earnings from continuing operations	\$ 41,269	\$ 20,940	\$ 37,701
Discontinued operations, net of tax	<u>32,133</u>	<u>(64,569)</u>	<u>17,931</u>
Net earnings (loss)	<u>\$ 73,402</u>	<u>\$ (43,629)</u>	<u>\$ 55,632</u>
Shares used in computing per share amounts:			
Weighted average number of common shares outstanding	43,539,950	43,160,860	42,312,522
Common stock equivalents (as determined by applying the treasury stock method)	<u>1,283,132</u>	<u>1,452,762</u>	<u>2,715,111</u>
Weighted average number of common shares and potential dilutive common shares outstanding	<u>44,823,082</u>	<u>44,613,622</u>	<u>45,027,633</u>
Net earnings (loss) per share:			
Basic:			
Continued operations	\$ 0.95	\$ 0.49	\$ 0.89
Discontinued operations	<u>0.74</u>	<u>(1.50)</u>	<u>0.42</u>
Earnings (loss) per common share	<u>\$ 1.69</u>	<u>\$ (1.01)</u>	<u>\$ 1.31</u>
Diluted:			
Continuing operations	\$ 0.92	\$ 0.47	\$ 0.84
Discontinued operations	<u>0.72</u>	<u>(1.45)</u>	<u>0.40</u>
Earnings (loss) per common share	<u>\$ 1.64</u>	<u>\$ (0.98)</u>	<u>\$ 1.24</u>

The calculation of diluted earnings per common share for 2007, 2006 and 2005 excludes the impact of 3,002,030, 4,560,036 and 328,250 shares, respectively, related to anti-dilutive stock options, restricted stock and restricted stock units.

**19. Segment Information**

Centene operates in two segments: Medicaid Managed Care and Specialty Services. The Medicaid Managed Care segment consists of Centene's health plans including all of the functions needed to operate them. The Specialty Services segment consists of Centene's specialty companies including behavioral health, life and health management, long-term care, managed vision, nurse triage, pharmacy benefits management and treatment compliance functions.

Factors used in determining the reportable business segments include the nature of operating activities, existence of separate senior management teams, and the type of information presented to the Company's chief operating decision maker to evaluate all results of operations.

**CENTENE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Segment information as of and for the year ended December 31, 2007, follows:

	<u>Medicaid Managed Care</u>	<u>Specialty Services</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenue from external customers	\$ 2,673,930	\$ 245,362	\$ —	\$ 2,919,292
Revenue from internal customers	<u>78,947</u>	<u>422,138</u>	<u>(501,085)</u>	<u>—</u>
Total revenue	<u>\$ 2,752,877</u>	<u>\$ 667,500</u>	<u>\$ (501,085)</u>	<u>\$ 2,919,292</u>
Earnings from operations	<u>\$ 31,307</u>	<u>\$ 22,786</u>	<u>\$ —</u>	<u>\$ 54,093</u>
Total assets	<u>\$ 936,311</u>	<u>\$ 182,811</u>	<u>\$ —</u>	<u>\$ 1,119,122</u>
Stock compensation expense	<u>\$ 13,974</u>	<u>\$ 1,505</u>	<u>\$ —</u>	<u>\$ 15,479</u>
Depreciation expense	<u>\$ 20,547</u>	<u>\$ 2,677</u>	<u>\$ —</u>	<u>\$ 23,224</u>
Capital expenditures	<u>\$ 49,996</u>	<u>\$ 3,941</u>	<u>\$ —</u>	<u>\$ 53,937</u>

Segment information as of and for the year ended December 31, 2006, follows:

	<u>Medicaid Managed Care</u>	<u>Specialty Services</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenue from external customers	\$ 1,770,019	\$ 191,975	\$ —	\$ 1,961,994
Revenue from internal customers	<u>94,984</u>	<u>233,263</u>	<u>(328,247)</u>	<u>—</u>
Total revenue	<u>\$ 1,865,003</u>	<u>\$ 425,238</u>	<u>\$ (328,247)</u>	<u>\$ 1,961,994</u>
Earnings from operations	<u>\$ 19,024</u>	<u>\$ 8,778</u>	<u>\$ —</u>	<u>\$ 27,802</u>
Total assets	<u>\$ 723,698</u>	<u>\$ 171,282</u>	<u>\$ —</u>	<u>\$ 894,980</u>
Stock compensation expense	<u>\$ 13,820</u>	<u>\$ 920</u>	<u>\$ —</u>	<u>\$ 14,740</u>
Depreciation expense	<u>\$ 13,233</u>	<u>\$ 2,377</u>	<u>\$ —</u>	<u>\$ 15,610</u>
Capital expenditures	<u>\$ 46,420</u>	<u>\$ 3,872</u>	<u>\$ —</u>	<u>\$ 50,292</u>

Segment information as of and for the year ended December 31, 2005, follows:

	<u>Medicaid Managed Care</u>	<u>Specialty Services</u>	<u>Eliminations</u>	<u>Consolidated Total</u>
Revenue from external customers	\$ 1,171,871	\$ 60,331	\$ —	\$ 1,232,202
Revenue from internal customers	<u>69,685</u>	<u>34,070</u>	<u>(103,755)</u>	<u>—</u>
Total revenue	<u>\$ 1,241,556</u>	<u>\$ 94,401</u>	<u>\$ (103,755)</u>	<u>\$ 1,232,202</u>
Earnings from operations	<u>\$ 54,919</u>	<u>\$ (2,648)</u>	<u>\$ —</u>	<u>\$ 52,271</u>
Total assets	<u>\$ 601,740</u>	<u>\$ 66,290</u>	<u>\$ —</u>	<u>\$ 668,030</u>
Stock compensation expense	<u>\$ 4,714</u>	<u>\$ 97</u>	<u>\$ —</u>	<u>\$ 4,811</u>
Depreciation expense	<u>\$ 7,398</u>	<u>\$ 411</u>	<u>\$ —</u>	<u>\$ 7,809</u>
Capital expenditures	<u>\$ 23,974</u>	<u>\$ 1,763</u>	<u>\$ —</u>	<u>\$ 25,737</u>

**CENTENE CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The Company evaluates performance and allocates resources based on earnings from operations. The accounting policies are the same as those described in the "Summary of Significant Accounting Policies" included in Note 2.

**20. Comprehensive Earnings**

Differences between net earnings and total comprehensive earnings resulted from changes in unrealized gains on investments available for sale, as follows:

	<u>Year Ended December 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Net earnings (loss)	\$73,402	\$(43,629)	\$55,632
Reclassification adjustment, net of tax	(242)	218	138
Change in unrealized losses on investments available for sale, net of tax	<u>3,064</u>	<u>285</u>	<u>(1,485)</u>
Total comprehensive earnings (loss)	<u>\$76,224</u>	<u>\$(43,126)</u>	<u>\$54,285</u>

**21. Subsequent Events**

In November 2007, the Company's subsidiary, Peach State Health Plan, received a contract amendment from the State of Georgia for their state fiscal year beginning July 1, 2007. The contract amendment increased the applicable premium rates and the State also mandated service changes, retroactively recalculated certain rate cells and adjusted for duplicate member issues. The Company executed the amendment on November 16, 2007. In January 2008, the State of Georgia returned a fully executed contract amendment. The amendment contained a premium revenue increase effective July 1, 2007. The revenue increase attributable to the period from July 1, 2007 through December 31, 2007, approximately \$20,800, will be recorded in the Company's consolidated statement of operations in the first quarter of 2008.

**Schedule I**  
**CONDENSED FINANCIAL INFORMATION OF REGISTRANT**  
**Centene Corporation (Parent Company Only)**  
**Condensed Balance Sheets**  
**(In thousands, except share data)**

	<u>December 31,</u>	
	<u>2007</u>	<u>2006</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 14,291	\$ 1,649
Short-term investments, at fair value (amortized cost \$5,202 and \$1,749, respectively)	5,190	1,747
Other current assets	<u>70,279</u>	<u>22,950</u>
Total current assets	89,760	26,346
Long-term investments, at fair value (amortized cost \$11,658 and \$8,344, respectively)	11,972	8,194
Investment in subsidiaries	492,706	443,689
Other assets	<u>6,236</u>	<u>1,244</u>
Total assets	<u><u>\$600,674</u></u>	<u><u>\$479,473</u></u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities	\$ 5,527	\$ 3,923
Long-term debt	180,000	149,000
Other liabilities	<u>100</u>	<u>127</u>
Total liabilities	185,627	153,050
Stockholders' equity:		
Common stock, \$.001 par value; authorized 100,000,000 shares; issued and outstanding 43,667,837 and 43,369,918 shares, respectively	44	44
Additional paid-in capital	221,693	209,340
Accumulated other comprehensive income:		
Unrealized loss on investments, net of tax	1,571	(1,251)
Retained earnings	<u>191,739</u>	<u>118,290</u>
Total stockholders' equity	<u>415,047</u>	<u>326,423</u>
Total liabilities and stockholders' equity	<u><u>\$600,674</u></u>	<u><u>\$479,473</u></u>

*See notes to condensed financial information of registrant.*

**Centene Corporation (Parent Company Only)**  
**Condensed Statements of Operations**  
(In thousands, except share data)

	Year Ended December 31,		
	2007	2006	2005
<b>Expenses:</b>			
General and administrative expenses	\$ (5,513)	\$ (3,709)	\$ (3,801)
<b>Other income (expense):</b>			
Investment and other income	913	755	743
Interest expense	(13,627)	(8,993)	(3,117)
Loss before income taxes	(18,227)	(11,947)	(6,175)
<b>Income tax benefit</b>	(51,178)	(4,504)	(2,551)
Net earnings (loss) before equity in subsidiaries	32,951	(7,443)	(3,624)
Equity in earnings (loss) from subsidiaries	40,451	(36,186)	59,256
<b>Net earnings (loss)</b>	<u>\$ 73,402</u>	<u>\$ (43,629)</u>	<u>\$ 55,632</u>
<b>Net earnings (loss) per share:</b>			
Basic earnings (loss) per common share	\$ 1.69	\$ (1.01)	\$ 1.31
Diluted earnings (loss) per common share	\$ 1.64	\$ (0.98)	\$ 1.24
<b>Weighted average number of shares outstanding:</b>			
Basic	43,539,950	43,160,860	42,312,522
Diluted	44,823,082	44,613,622	45,027,633

*See notes to condensed financial information of registrant.*

**Centene Corporation (Parent Company Only)**  
**Condensed Statements of Cash Flows**  
(In thousands)

	Year Ended December 31,		
	2007	2006	2005
<b>Cash flows from operating activities:</b>			
Cash provided by operating activities	\$ 94,145	\$ 31,895	\$ 11,622
<b>Cash flows from investing activities:</b>			
Net dividends from and capital contributions to subsidiaries	(71,813)	(43,100)	(22,300)
Purchase of investments	(84,088)	(4,521)	(4,438)
Sales and maturities of investments	77,086	5,841	26,697
Acquisitions, net of cash acquired	(38,532)	(66,772)	(55,485)
Proceeds from asset sales	14,102	—	—
Net cash used in investing activities	(103,245)	(108,552)	(55,526)
<b>Cash flows from financing activities:</b>			
Proceeds from borrowings	212,000	86,000	45,000
Payment of long-term debt and notes payable	(181,000)	(12,000)	(4,000)
Proceeds from exercise of stock options	5,464	6,953	5,621
Common stock repurchases	(9,541)	(7,883)	—
Debt issue costs	(5,181)	(253)	(413)
Excess tax benefits from stock compensation	—	3,043	—
Net cash provided by financing activities	21,742	75,860	46,208
Net increase (decrease) in cash and cash equivalents	12,642	(797)	2,304
Cash and cash equivalents, beginning of period	1,649	2,446	142
<b>Cash and cash equivalents, end of period</b>	<u>\$ 14,291</u>	<u>\$ 1,649</u>	<u>\$ 2,446</u>

*See notes to condensed financial information of registrant.*



## **Notes to Condensed Financial Information of Registrant**

### **Note A – Basis of Presentation and Significant Accounting Policies**

In Centene Corporation's parent company only financial statements, Centene Corporation's investment in subsidiaries is stated at cost plus equity in undistributed earnings of the subsidiaries. Centene Corporation's share of net income of its unconsolidated subsidiaries is included in income using the equity method of accounting.

Certain amounts presented in the parent company only financial statements are eliminated in the consolidated financial statements of Centene Corporation. The income tax benefit reflects a \$34,856 tax benefit associated with the stock abandonment discussed in Note 3.

Centene Corporation's parent company only financial statements should be read in conjunction with Centene Corporation's audited consolidated financial statements and the notes to consolidated financial statements included in this Form 10-K.

### **Note B – Dividends**

During 2007, 2006 and 2005, the Registrant received dividends from its subsidiaries totaling \$53,937, \$8,600 and \$7,000, respectively.

# EXHIBIT INDEX

EXHIBIT NUMBER	DESCRIPTION	FILED WITH THIS FORM 10-K	INCORPORATED BY REFERENCE <sup>1</sup>		
			FORM	FILING DATE WITH SEC	EXHIBIT NUMBER
3.1	Certificate of Incorporation of Centene Corporation		S-1	October 9, 2001	3.2
3.1a	Certificate of Amendment to Certificate of Incorporation of Centene Corporation, dated November 8, 2001		S-1/A	November 13, 2001	3.2a
3.1b	Certificate of Amendment to Certificate of Incorporation of Centene Corporation as filed with the Secretary of State of the State of Delaware		10-Q	July 26, 2004	3.1b
3.2	By-laws of Centene Corporation		S-1	October 9, 2001	3.4
4.1	Amended and Restated Shareholders' Agreement, dated September 23, 1998		S-1	October 9, 2001	4.2
4.2	Rights Agreement between Centene Corporation and Mellon Investor Services LLC, as Rights Agent, dated August 30, 2002		8-K	August 30, 2002	4.1
4.2a	Amendment No. 1 to Rights Agreement by and between Centene Corporation and Mellon Investor Services LLC, as right agent, dated April 23, 2007.		8-K	April 26, 2007	4.1
4.3	Indenture for the 7¼% Senior Notes due 2014 dated March 22, 2007 among Centene Corporation and The Bank of New York Trust Company, N.A., as trustee.		S-4	May 11, 2007	4.3
10.1	Contract Between the Georgia Department of Community Health and Peach State Contract for provision of Services to Georgia Health Families		8-K	July 22, 2005	10.1
10.1a	Amendment #1 to the Contract No. 0653 Between Georgia Department of Community Health and Peach State		10-Q	October 25, 2005	10.9
10.1b	Amendment #2 to the Contract No. 0653 Between Georgia Department of Community Health and Peach State	X			
10.1c	Notice of Renewal for fiscal year 2007 between Peach State Health Plan, Inc. and Georgia Department of Community Health.		10-Q	October 24, 2006	10.3
10.1d	Notice of Renewal for fiscal year 2008 between Peach State Health Plan, Inc. and Georgia Department of Community Health.		10-Q	July 24, 2007	10.4
10.2	Contract between the Texas Health and Human Services Commission and Superior HealthPlan, Inc.		10-K	February 24, 2006	10.5
10.2a	Amendment F (Version 1.6) to Contract between the Texas Health and Human Services Commission and Superior HealthPlan, Inc.		10-K	February 23, 2007	10.4a
10.2b	Amendment G (Version 1.7) to Contract between the Texas Health and Human Services Commission and Superior HealthPlan, Inc.		10-Q	July 24, 2007	10.2
10.2c	Amendment H (Version 1.8) to Contract between the Texas Health and Human Services Commission and Superior HealthPlan, Inc.		10-Q	October 23, 2007	10.1
10.2d	Amendment I (Version 1.9) to Contract between the Texas Health and Human Services Commission and Superior HealthPlan, Inc.	X			
10.3	1996 Stock Plan of Centene Corporation, shares which are registered on Form S-8 — File Number 333-83190		S-1	October 9, 2001	10.9
10.4	1998 Stock Plan of Centene Corporation, shares which are registered on Form S-8 — File number 333-83190		S-1	October 9, 2001	10.10

10.5	1999 Stock Plan of Centene Corporation, shares which are registered on Form S-8 — File Number 333-83190	S-1	October 9, 2001	10.11
10.6	2000 Stock Plan of Centene Corporation, shares which are registered on Form S-8 — File Number 333-83190	S-1	October 9, 2001	10.12
10.7	2002 Employee Stock Purchase Plan of Centene Corporation, shares which are registered on Form S-8 — File Number 333-90976	10-Q	April 29, 2002	10.5
10.7a	First Amendment to the 2002 Employee Stock Purchase Plan	10-K	February 24, 2005	10.9a
10.7b	Second Amendment to the 2002 Employee Stock Purchase Plan	10-K	February 24, 2006	10.10b
10.8	2003 Stock Incentive Plan, as amended	8-K	April 26, 2007	10.1
10.9	Centene Corporation Non-Employee Directors Deferred Stock Compensation Plan	10-Q	October 25, 2004	10.1
10.9a	First Amendment to the Non-Employee Directors Deferred Stock Compensation Plan	10-K	February 24, 2006	10.12a
10.10	Centene Corporation Employee Deferred Compensation Plan	10-Q	April 24, 2007	10.4
10.11	Centene Corporation Amended and Restated 2003 Stock Incentive Plan	8-K	April 26, 2007	10.1
10.12	Centene Corporation 2007 Long-Term Incentive Plan	8-K	April 26, 2007	10.2
10.13	Executive Employment Agreement between Centene Corporation and Michael F. Neidorff, dated November 8, 2004	8-K	November 9, 2004	10.1
10.14	Form of Executive Severance and Change in Control Agreement	8-K	May 23, 2005	10.1
10.15	Form of Restricted Stock Unit Agreement	8-K	April 28, 2006	10.1
10.16	Form of Non-statutory Stock Option Agreement (Non-Employees)	8-K	July 28, 2005	10.3
10.17	Form of Non-statutory Stock Option Agreement (Employees)	8-K	July 28, 2005	10.4
10.18	Form of Incentive Stock Option Agreement	8-K	July 28, 2005	10.5
10.19	Form of Stock Appreciation Right Agreement	8-K	July 28, 2005	10.6
10.20	Form of Restricted Stock Agreement	10-Q	October 25, 2005	10.8
10.21	Form of Performance Based Restricted Stock Unit Agreement	8-K	December 28, 2007	10.1
10.22	Form of Long Term Incentive Plan Agreement	8-K	February 7, 2008	10.1
10.23	Credit Agreement dated as of September 14, 2004 among Centene Corporation, the various financial institutions party hereto and LaSalle Bank National Association	10-Q	October 25, 2004	10.2
10.23a	Amendment No. 2 to Credit Agreement dated as of September 14, 2004 among Centene Corporation, the various financial institutions party hereto and LaSalle Bank National Association	10-Q	October 25, 2005	10.11
10.23b	Amendment No. 3 to Credit Agreement dated as of September 14, 2004 among Centene Corporation, the various financial institutions party hereto and LaSalle Bank National Association	10-K	February 24, 2006	10.22b
10.23c	Amendment No. 4 to Credit Agreement dated as of September 14, 2004 among Centene Corporation, the various financial institutions party hereto and LaSalle Bank National Association	10-Q	July 25, 2006	10.2

10.23d	Amendment No. 5 to Credit Agreement dated as of September 14, 2004 among Centene Corporation, the various financial institutions party hereto and LaSalle Bank National Association	10-Q	October 24, 2006	10.1
10.23e	Amendment No. 6 to Credit Agreement dated as of September 14, 2004 among Centene Corporation, the various financial institutions party hereto and LaSalle Bank National Association	X		
10.24	Summary of Board of Director Compensation	X		
10.25	Summary of Compensatory Arrangements with Executive Officers	X		
12.1	Computation of ratio of earnings to fixed charges	X		
21	List of subsidiaries	X		
23	Consent of Independent Registered Public Accounting Firm incorporated by reference in each prospectus constituting part of the Registration Statements on Form S-3 (File Number 333-119944) and on Form S-8 (File Numbers 333-108467, 333-90976 and 333-83190).	X		
31.1	Certification Pursuant to Rule 13a-14(a) and 15d-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Executive Officer)	X		
31.2	Certification Pursuant to Rule 13a-14(a) and 15d-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Chief Financial Officer)	X		
32.1	Certification Pursuant to 18 U.S.C. Section 1350 (Chief Executive Officer)	X		
32.2	Certification Pursuant to 18 U.S.C. Section 1350 (Chief Financial Officer)	X		

<sup>1</sup> SEC File No. 001-31826 (for filings prior to October 14, 2003, the Registrant's SEC File No. was 000-33395).

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, as of February 25, 2008.

### CENTENE CORPORATION

By: /s/ MICHAEL F. NEIDORFF

**Michael F. Neidorff**  
**Chairman and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the registrant and in the capacities as indicated, as of February 25, 2008.

<u>Signature</u>	<u>Title</u>
<u>/s/ MICHAEL F. NEIDORFF</u> <b>Michael F. Neidorff</b>	Chairman and Chief Executive Officer (principal executive officer)
<u>/s/ ERIC R. SLUSSER</u> <b>Eric R. Slusser</b>	Executive Vice President and Chief Financial Officer (principal financial and accounting officer)
<u>/s/ STEVE BARTLETT</u> <b>Steve Bartlett</b>	Director
<u>/s/ ROBERT K. DITMORE</u> <b>Robert K. Ditmores</b>	Director
<u>/s/ FRED H. EPPINGER</u> <b>Fred H. Eppinger</b>	Director
<u>/s/ RICHARD A. GEPHARDT</u> <b>Richard A. Gephhardt</b>	Director
<u>/s/ PAMELA A. JOSEPH</u> <b>Pamela A. Joseph</b>	Director
<u>/s/ JOHN R. ROBERTS</u> <b>John R. Roberts</b>	Director
<u>/s/ DAVID L. STEWARD</u> <b>David L. Steward</b>	Director
<u>/s/ TOMMY G. THOMPSON</u> <b>Tommy G. Thompson</b>	Director

## CERTIFICATION

I, Michael F. Neidorff, certify that:

1. I have reviewed this Annual Report on Form 10-K of Centene Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 25, 2008

/s/ MICHAEL F. NEIDORFF

Michael F. Neidorff  
Chairman and Chief Executive Officer  
(principal executive officer)

## CERTIFICATION

I, Eric R. Slusser, certify that:

1. I have reviewed this Annual Report on Form 10-K of Centene Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a - 15(f) and 15d - 15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 25, 2008

/s/ ERIC R. SLUSSER

Eric R. Slusser

Executive Vice President and Chief Financial Officer  
(principal financial and accounting officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report on Form 10-K of Centene Corporation (the Company) for the period ended December 31, 2007, as filed with the Securities and Exchange Commission on the date hereof (the Report), the undersigned, Michael F. Neidorff, Chairman and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 25, 2008

/s/ MICHAEL F. NEIDORFF

Michael F. Neidorff  
Chairman and Chief Executive Officer  
(*principal executive officer*)



**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report on Form 10-K of Centene Corporation (the Company) for the period ended December 31, 2007, as filed with the Securities and Exchange Commission on the date hereof (the Report), the undersigned, Eric R. Slusser, Executive Vice President and Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 25, 2008

/s/ ERIC R. SLUSSER

Eric R. Slusser  
Executive Vice President and Chief Financial Officer  
*(principal financial and accounting officer)*

## CORPORATE INFORMATION

### Board of Directors

Michael F. Neidorff  
*Chairman, President and CEO*

Steve Bartlett  
*President and CEO*  
*The Financial Services Roundtable*

Robert K. Ditmore  
*Former President and COO*  
*United Healthcare Corporation*

Frederick H. Eppinger  
*President and CEO*  
*The Hanover Insurance Group*

Richard A. Gephardt  
*CEO, Gephardt and Associates*  
*Former Majority Leader*  
*U.S. House of Representatives*

John R. Roberts  
*Retired Regional Managing Partner*  
*Arthur Andersen LLP*

David L. Steward  
*Chairman of the Board*  
*World Wide Technology, Inc.*

Tommy G. Thompson  
*Former Health and Human Services*  
*Secretary and Former Governor of*  
*Wisconsin*

Pamela A. Joseph  
*Vice Chairman, U.S. Bancorp*

### Senior Management

Michael F. Neidorff  
*Chairman, President and CEO*

Christopher D. Bowers  
*Sr. VP, Health Plan Business Unit*

Patricia J. Darnley  
*Sr. VP, Operations*

Mark W. Eggert  
*Executive VP, Health Plan Business Unit*

Marie J. Glancy  
*Sr. VP, Operational Services and*  
*Regulatory Affairs*

Carol E. Goldman  
*Executive VP, Chief Administrative Officer*

Cary D. Hobbs  
*Sr. VP, Business Management & Integration*

Jesse N. Hunter  
*Sr. VP, Corporate Development*

Edmund E. Kroll  
*Sr. VP, Finance & Investor Relations*

Mary V. Mason, M.D.  
*Sr. VP and Chief Medical Officer*

Robert C. Packman, M.D.  
*Sr. VP, Medical Affairs*

William N. Scheffel  
*Executive VP, Specialty Business Unit*

Glendon A. Schuster  
*Sr. VP and Chief Information Officer*

Eric R. Slusser  
*Executive VP, Chief Financial Officer*

Keith H. Williamson  
*Sr. VP, Secretary and General Counsel*

### Field Officers: Health Plans

Michael A. Cadger  
*President and CEO,*  
*Peach State Health Plan*

Keith Collins, M.D.  
*President and CEO, Total Carolina Care*

Richard L. Fredrickson  
*President and CEO,*  
*Buckeye Community Health Plan*

Mary C. Garcia  
*President and CEO,*  
*University Health Plans*

Patricia A. Liebman  
*Regional VP, President and CEO,*  
*Managed Health Services Indiana*

Linda A. McKnew  
*President and CEO,*  
*Managed Health Services Wisconsin*

Tom P. Wise  
*President and CEO, Superior HealthPlan*

### Field Officers: Specialty Companies

Robert A. Bagdasarian  
*President and CEO, US Script*

Daniel D. Cave  
*President and CEO, Nurtur*

Samuel A. Donaldson, Ph.D.  
*President and CEO,*  
*Cenpatico Behavioral Health*

Richard L. Fredrickson  
*President and CEO,*  
*Bridgeway Health Solutions*

Jason M. Harrold  
*President and CEO,*  
*OptiCare Managed Vision*

Kimberly D. Tuck  
*President and CEO, NurseWise*

### Corporate and Investor Information

Corporate Headquarters  
Centene Corporation  
7711 Carondelet Avenue  
St. Louis, Missouri 63105  
314.725.4477  
[www.centene.com](http://www.centene.com)

### Form 10-K

The Company has filed an Annual Report on Form 10-K for the year ended December 31, 2007, with the Securities and Exchange Commission. Stockholders may obtain a copy of this report, without charge, by writing:

Investor Relations  
Centene Corporation  
7711 Carondelet Avenue  
St. Louis, Missouri 63105

### Common Stock Information

Centene common stock is traded and quoted on the New York Stock Exchange under the symbol "CNC."

		High	Low
2006	First Quarter	\$30.26	\$22.70
	Second Quarter	29.59	22.88
	Third Quarter	23.87	13.25
	Fourth Quarter	26.95	16.11
2007	First Quarter	\$26.66	\$20.68
	Second Quarter	24.28	19.35
	Third Quarter	23.79	17.65
	Fourth Quarter	27.73	21.26

### Dividend Policy

The Company has not paid any dividends on its common stock and expects that its earnings will continue to be retained for use in the operation and expansion of its business.

### Annual Meeting

The Annual Meeting of Stockholders will be held on Tuesday, April 22, 2008, at 10:00 A.M. at The Ritz-Carlton St. Louis, 100 Carondelet Plaza, St. Louis, MO 63105 in the Amphitheater, 314.863.6300.

### Transfer Agent

BNY Mellon Shareowner Services  
480 Washington Boulevard  
Jersey City, NJ 07310-1900  
888.213.0965  
[www.melloninvestor.com](http://www.melloninvestor.com)



7711 Carondelet Avenue  
St. Louis, Missouri 63105  
P 314.725.4477  
F 314.725.5180  
[www.centene.com](http://www.centene.com)

**END**